Jurisdictional Statement

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IN THE

Supreme Court of the United States

October Term 1981

No. _____

JOHN K. SJONG,
Appellant,

vs.

STATE OF ALASKA,
Appellee.

ON APPEAL FROM THE
SUPREME COURT OF THE STATE OF ALASKA

JURISDICTIONAL STATEMENT

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PRELIMINARY STATEMENT

Appellant is a nonresident commercial fisherman who sells crab caught exclusively in international waters according to prearranged contracts negotiated outside the taxing state. Except for incidental stops, appellant's only contact with the taxing state occurs when he comes into port to deliver his catch. Payment therefor is made in Washington State where appellant's business is based and where all other business activities occur.

QUESTIONS PRESENTED BY THE APPEAL

1. Does the State lack the sufficiently substantial nexus to appellant's activities required by the commerce and fourteenth amendment due process clauses to tax his net income derived from such sales?

2. Is an allocation to the taxing state of 85-92% of net income derived from such sales a fair apportionment under the commerce and fourteenth amendment due process and equal protection clauses where appellant conducts only a small percentage of his business activities within the taxing state?

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of Alaska is reported at 622 P.2d 967 (1981) and is reprinted in Appendix D hereto.

The opinion of the Superior Court of Alaska was oral. The transcript thereof is reprinted in Appendix E hereto.

The two-part decision of the Alaska State Department of Revenue is not reported, but is reprinted in Appendices F and G hereto.

JURISDICTION

The opinion of the Supreme Court of Alaska sustaining the validity of state taxation of appellant's net income against federal commerce clause, due process, and equal protection challenges was issued on January 23, 1981. An order denying the petition for rehearing was entered on June 4, 1981, Appendix A, and the mandate was issued on June 5, 1981, Appendix B . A notice of appeal to this Court was filed in the Supreme Court of Alaska on July 13, 1981. Appendix C . The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2). *See Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 440-441 (1979).

CONSTITUTIONAL PROVISIONS AND STATUTES

The pertinent text of the following constitutional provisions and statutes is set forth in Appendix H hereto.

Federal:

U.S. Const., art. I, § 8

U.S. Const., amend. XIV

State:

Alaska Stat. § 43.19.010 (1977)

Alaska Stat. § 45.02.106(a) (1980)

Alaska Stat. § 45.02.401(1) (1980)

Ch. 115, § 5(a)(2)(b), 1949 Alaska Sess. Laws

Ch. 132, § 5(d), 1951 Alaska Sess. Laws

Ch. 175, § 5(c)(20), 1959 Alaska Sess. Laws

Alaska Stat. § 43.20.130 (repealed 1975)

Alaska Stat. § 43.20.071 (1977), *as amended by* Alaska Stat § 43.20.071 (Cum. Supp. 1980)

STATEMENT OF THE CASE

Appellant, John K. Sjong, representing eleven similarly situated nonresident fishermen, brings this action as a test case of the constitutionality of imposing the Alaska net income tax on the income of nonresident crab fishermen derived from sales of crab caught exclusively in international waters but delivered to Alaska ports pursuant to contracts negotiated outside the state. Sjong also contests the apportionment of income made to Alaska by its department of revenue.

A. STATEMENT OF THE FACTS OF THE CASE.

Appellant, John K. Sjong, is a resident of the state of Washington. A commercial king crab fisherman, he fishes exclusively in international waters 5 to 150 miles off the coast of Alaska. Except for emergency stops, he enters Alaska only when he delivers his catch.

Sjong owns and operates a crabbing vessel, which was built outside of Alaska and has Seattle, Washington, as its designated home port. The vessel is insured, licensed, registered, harbored, and subject to local property taxes in Washington. Bank accounts, financial and business records, and the attorney and accountant for the boat are in Washington.

During most of the year the vessel is located in Seattle, where improvements and substantially all repairs are made. No major repair work has been done in Alaska.

Minor emergency repairs have occurred there only three or four times over several seasons; in most cases, these were performed by representatives of Seattle-based firms, which billed Sjong in Seattle.

Sjong hires his crew and outfits his vessel in the state of Washington. Crew members are usually Washington residents, although in some years Sjong has engaged Alaskan residents as emergency replacements for regular crew members who have quit or become ill during the season. Fuel taken on in Washington may be sufficient to last the entire season, although Sjong has acquired some fuel in Alaska. Food supplies acquired in Washington are also designed to last the entire season. Sjong's grocery purchases in Alaska are minimal and are limited to fresh produce for salads, generally available in only one of three ports to which Sjong may deliver.

Prior to the season Sjong secures a market and negotiates a price for his catch in Seattle with processors domiciled in the state of Washington. All terms of the buyer-seller relationship are settled in Seattle.

During the crab season Sjong fishes exclusively in international waters with bait purchased at his buyers' receiving stations in Alaska. He comes into an Alaska port twenty to thirty times a season to deliver his catch pursuant to the terms of the marketing agreement reached in Seattle. Once in port, delivery is made quickly to enable the vessel to return to the fishing grounds as soon as possible—often within a day. Payment for the catch is made in Seattle after the end of the season.

B. STATEMENT OF THE PROCEDURE OF THE CASE.

On February 20, 1974, in response to a request by Sjong, the Alaska State Department of Revenue issued Revenue Ruling 74-2,[1] which provided that where fish products were taken in international waters and delivered in Alaska only, apportionment should not apply and all income should be reported to Alaska, regardless of the fisherman's activities in other states. On October 10, 1974, the department of revenue sent Sjong an assessment for $32,481.79 in unpaid taxes.

Sjong appealed, asserting that Alaska had no jurisdiction to tax and that even if a tax could be imposed, the department's assessment was not reasonably apportioned. In a two-part decision, the department hearing examiner ruled that Alaska had jurisdiction (Appendix F) and that the tax must be apportioned (Appendix G). The department thereafter calculated Sjong's tax by apportioning his income in a manner that attributed 92.0% of his income to Alaska for 1972, 85.2% for 1971, and 84.9% for 1970.

On appeal to the Alaska courts, Sjong reiterated his jurisdictional claims and contended that the department's apportionment was grossly unfair, relying on the commerce clause and the due process and equal protection clauses of the fourteenth amendment of the United States Constitution. Both the superior court (Appendix E) and

1. Revenue Ruling 74-2 is quoted in part by the opinion of the court below. 622 P.2d at 976; Appendix D at D-17, and is reported in [1974] Alaska Tax Rep. (CCH) § 200-160 (1974).

the Alaska Supreme Court (Appendix D) affirmed the department of revenue action.

STATEMENT OF SUBSTANTIALITY

This case involves a single taxpayer, but the manifest unfairness of the department of revenue action concerning Sjong so far departs from constitutional limits that review of the case is merited on that basis alone.

The significance of this case, however, goes well beyond its impact on Sjong. The Alaska State Department of Revenue has agreed that this is a test case, and eleven other nonresident fishermen have expressly agreed to be bound by its outcome. The State of Alaska will also levy similar taxes on all other nonresident crab fishermen who enter Alaska. The value of the annual Alaska king crab catch alone ensures that several million dollars of back and future taxes will be at stake.[2]

Moreover, the Alaska Attorney General has publicly emphasized that this case is "extraordinarily important" and "is the one major case" upon which Alaska will rely in other tax litigation, particularly cases involving taxation of the oil industry. The "enormous latitude" allowed by the Alaska Supreme Court is considered to be very significant by the State in formulating its overall tax policy. *See* Appendix I . Since the decision of the Alaska courts goes well beyond federal constitutional limits and will have sweeping impact if allowed to stand, review by this Court is warranted.

2. In 1980, for instance, the Alaska king crab catch was worth more than $166,500,000 to the fishermen. Interview with Bob Alverson, Manager of the Alaska Marketing Association, in Seattle (Aug. 3, 1981).

A. STATE TAXATION OF INCOME OF NONRESIDENT FISHERMEN WHO SELL FISH CAUGHT EXCLUSIVELY IN INTERNATIONAL WATERS PURSUANT TO CONTRACTS NEGOTIATED OUTSIDE THE STATE FAILS TO MEET THE SUBSTANTIAL NEXUS REQUIREMENT OF THE COMMERCE AND FOURTEENTH AMENDMENT DUE PROCESS CLAUSES.

To comport with the commerce and due process clauses, a state tax must be "applied to an activity with a *substantial nexus* with the taxing State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (emphasis added); *See National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967). Permitting Alaska to tax the income of a nonresident fisherman who sells fish caught exclusively in international waters pursuant to contracts negotiated outside the state merely because he delivers his catch to an Alaska port severely weakens the substantial nexus requirement and represents an unprecedented expansion of a State's power to tax interstate commerce.

Indeed, this Court has already rejected a State's attempt to tax based upon mere delivery into the taxing state. In *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954), a nonresident seller sold goods ordered and paid for out of state to residents of the taxing state. In two-thirds of those sales, the seller delivered the goods to the buyer's residence. Delivery was the seller's only major contact with the taxing state, although it did engage in incidental media and direct mail advertising to residents. This Court held that there was insufficient nexus to impose a use tax.

The use tax context of *Miller* is particularly signifi-

cant to the instant case, for a direct tax such as the Alaska net income tax requires an even greater nexus than a use tax. *See National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 558 (1977). Thus, the connection between Sjong's income-generating activities and the state of Alaska must be more than *Miller* would require.

Even under the less stringent *Miller* use tax standards, Sjong's activities fall short of the required nexus to the taxing state. Sjong negotiates for a buyer and a price for his catch outside of Alaska. He acquires his catch and is paid therefor outside Alaska. His only contact with Alaska, aside from incidental emergency stops, occurs upon delivery to an Alaska port. Thus, Sjong—like the vendor in *Miller*—is merely a nonresident seller who delivers goods ordered and paid for out of state to buyers in the taxing state.[3]

3. The Alaska Supreme court distinguished *Miller*, stating that there the sales occurred out of state, whereas Sjong's physical transfer of his catch to the buyer was more than mere delivery and constituted a sale in Alaska under section 43.20.130(e)(1) of the Alaska Statutes. 622 P.2d at 972-73. *See generally* Multistate Tax Compact, art. IV, § 16(a), Alaska Stat. § 43.19.010 (1977); Alaska Stat. §§ 45.02.160(a), .401(2) (1980). Under sections 2-106(1) and 2-401(2) of the Uniform Commercial Code, a "sale" will normally occur upon physical delivery, even though the contract for sale and payment thereunder may occur elsewhere. If the U.C.C. or other similar statute had been in effect in the *Miller* case, the nonresident vendor's sale of merchandise delivered to residents of the taxing state would have occurred in the taxing state. Under the Alaska court's reasoning, States could avoid the *Miller* result simply by defining a sale to occur at the time of physical delivery. Thus, the constitutional power to tax would turn upon a mere semantic difference. Such a result would be the type of "triumph of formalism over substance" that this Court firmly rejected in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 281, 288-89 (1977).

Review of the cases in which this Court has found the power to tax further demonstrates the novel diluted approach to the substantial nexus requirement that the State of Alaska would have this Court adopt. None has involved a relationship between the taxing state and the taxed activity as tenuous as the one presented here. The taxing state has prevailed only where the taxpayer has maintained at least an office or other fixed property therein,[4] or where the taxpayer has used *resident* representatives to engage in systematic solicitation,[5] or to provide continuing technical assistance regarding the products sold.[6]

In contrast, appellant Sjong maintains no office or fixed property in Alaska. He conducts no solicitation there and provides no technical assistance to buyers of his catch. He has no resident representative engaged in any systematic or continuing business activity within the state. His only contact with Alaska occurs when he delivers his catch. Although he may sometimes obtain fuel, bait, or water when he is in port, such activity is transitory and does not rise to the level of systematic and continuous activity within the taxing state that the com-

4. *See e.g., National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951); *Ott v. Mississippi Valley Barge Line Co.*, 336 U.S. 169 (1949); *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940); *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924). *Cf. Central Greyhound Lines, Inc. v. Mealey*, 344 U.S. 653 (1948) (tax on transportation company's gross receipts must be apportioned as to mileage *within* taxing state).

5. *See' e.g., Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

6. *See Standard Pressed Steel Co. v. Department of Revenue*, 419 U.S. 560 (1975).

merce and due process clauses require.[7] Thus, to permit the Alaska Supreme Court's decision to stand would signify an unprecedented extension of the State's taxing power in interstate commerce.

B. ALASKA'S SPECIAL APPORTIONMENT FORMULA, WHICH IS TAILORED TO MAXIMIZE THE TAX ON NONRESIDENT FISHERMEN, PRODUCES A GROSSLY DISTORTED RESULT BY ATTRIBUTING 90% OF THEIR INCOME TO ALASKA EVEN THOUGH 95% OF THEIR BUSINESS ACTIVITY IS OUTSIDE THE STATE.

1. **The Apportionment Formula Devised for Nonresident Fishermen Bases All Three Factors on the Delivery of Crab, the Only Significant Contact with Alaska.** In its original tax assessment, the department of revenue refused to apportion Sjong's income at all and allocated it entirely to Alaska.[8] This decision was based solely on the fact that crab caught by Washington-based fishermen in international waters were delivered first to Alaska ports from which the crab were shipped to other states for final processing and sale. The deliveries in

7. In *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), this Court stated: "The case in this Court which represents the furthest constitutional reach to date of a State's power [to impose a use tax on a nonresident seller] is Scripto, Inc. v. Carson." *Id.* at 757. In *Scripto*, 362 U.S. 207 (1960), the nonresident seller's resident independent contractors engaged in continuous in-state solicitation. Because the power to impose a net income tax requires a greater nexus than the power to impose a use tax, Sjong's activities within Alaska simply do not reach the currently required degree of continuity within the taxing state.

8. The department's action was based on Revenue Ruling 74-2. *See* note 1 and accompanying text, supra.

Alaska were made pursuant to contracts negotiated in Washington with Washington based processing companies. Payment for the crab delivered was made in Washington.

Sjong appealed. After an administrative hearing, the department of revenue hearing examiner ruled that while Alaska had jurisdiction to tax, Sjong's contacts with the state of Washington required that his income be apportioned between Washington and Alaska.[9] The hearing examiner declined, however, to apply the standard three-factor apportionment formula provided for in Alaska Stat. § 43.20.130.[10] Instead, he proposed an alternate formula, applying measures of the sales, property, and payroll factors especially devised for nonresident fishermen.

For the sales factor, the examiner ruled that initial delivery to a purchaser in Alaska constituted a sale regardless of the other conditions or facts relating to the sale.[11] For a fisherman delivering his catch to Alaska ports for shipment onward in interstate commerce, pursuant to a contract negotiated and paid in Washington, the sales factor was thus attributed 100% to Alaska.

In deriving the property and payroll factors, the examiner chose to ignore the usual location of the fisher-

9. *See* Appendices F and G.

10. In 1959, immediately upon statehood, Alaska became the first state to adopt the Uniform Division of Income for Tax Purposes Act (UDITPA), ch. 175, SLA 1959, which provided for apportionment of income on the basis of sales, payroll, and property factors. This standard formula is also utilized by the Multistate Tax Compact adopted by Alaska in 1970. Alaska Stat. § 43.20.130 was repealed in 1975 as part of a revision and recodification of Alaska's income tax, but the same three-factor formula continues to apply and is found in Alaska Stat. § 43.19.010, art. IV.

11. *See generally* note 3 *supra*.

man's vessel,[12] and refused to accept Sjong's suggestion that property and payroll be apportioned based on a voyage or a service days concept. That ratio would compare the number of days during which services are rendered inside the state to the total number of days during which services are rendered inside and outside the state. Instead, the examiner required that a port days method be applied, applying by analogy a statutory provision designed for Alaska steamship service, Alaska Stat. § 43.20.130(g).[13] As limited in the hearing examiner's decision, the port-days method considers all time spent in Alaska delivering crab, but it ignores all the time spent fishing and virtually all of the time the vessel is in its home port in Washington, where repairs and modifications are made, where markets are negotiated—indeed where all business is conducted except fishing and delivery. See Appendix G at 9-12.

12. The vessel is registered in the State of Washington, and Seattle is designated as its home port. King County, Washington, levies a personal property tax on the vessel and also on the bank accounts in Seattle that pertain to the vessel.

13. Alaska Stat. § 43.20.130(g) was originally enacted by the Alaska Territorial Legislature in 1949 as part of Alaska's first income tax. Ch. 115, SLA 1949. Section 5(A)(2)(6) of that statute was entitled "DETERMINATION OF PROPERTY AND PAYROLL FACTORS FOR FREIGHT AND PASSENGER CARRIERS" and contained language identical to that in section 130(g), except that it referred to Alaska as a territory rather than a state. The language was unchanged by a 1951 amendment that renumbered the section as 5(d). Ch. 132, SLA 1951. In 1959, upon attaining statehood, section 5(d) was re-enacted as section 5(C)(1)(20) and the language "Determination of property and payroll factors for freight and passenger carriers," was included in the text of the section. Ch. 175, SLA 1959. Upon codification, the publisher omitted the legislature's language quoted above from the text of the section as codified, Alaska Stat. § 43.20.130(g), creating the confusion in this case. Any doubt about the legislature's continuing intent was eliminated in 1976 when the legislature re-enacted the section as Alaska Stat. § 43.20.071, entitled "Passenger or freight water transportation carriers," and provided that all three factors—property, payroll and sales—should be apportioned for water transportation carriers on a days-spent-in-port basis. *See* Appendix H.

Alaska Stat. § 43.20.130(g), relating to port days, called for use of that method, where applicable, in computing both the property value of vessels and the payroll for employees. The hearing examiner noted two alternate methods of calculating the payroll factor. Relying on the provisions of AS 43.20.130(g), he apportioned both property and payroll for the fishing vessel using the port days method. However, the department of revenue rejected the examiner's decision and chose to apply a different method for appointment for payroll. 622 P.2d at 977; Appendix D at D-19.

The department of revenue auditor decided that since compensation of employees on the fishing vessel was based on the value of the catch, payroll should be apportioned using the sales factor. This change in the payroll factor was made without notice, hearing, or any basis in the record to support a finding that the port days method preferred by the hearing examiner did not reasonably approximate the value of wages accountable for by the business transacted in Alaska.

The effect of the auditor's decision to substitute the sales factor for the port days method in computing the payroll factor was to abandon even the limited apportionment of payroll provided by a port days computation. The sales factor, as discussed above, considered only deliveries and attributed sales 100% to Alaska. The auditor's action caused the fishing payroll also be to attributed 100% to Alaska. The overall result was an apportionment formula that yielded a result very close to what the department had tried to do in the first place: the allocation of 100% of the

income of Washington-based crab fishermen to Alaska.

In Revenue Ruling 74-2, the department of revenue had called for no apportionment of income and, looking only at deliveries, had allocated Sjong's income 100% to Alaska. The hearing examiner rejected that approach and required apportionment. But the final decision, as applied by the department of revenue, set aside the standard apportionment formula and used a sales factor based only on deliveries attributed 100% to Alaska; a payroll factor based only on deliveries attributed 100% to Alaska; and a property factor based on a port days method construed to exclude virtually all days except when deliveries were made in Alaska. The result was an overall attribution of income to Alaska of 92% in 1972; 85.2% in 1971, and 84.9% in 1970.[14]

2. **The Courts Below Said the Department's Apportionment Was Unfair but Felt Compelled by *Moorman* To Uphold a Formula Based Almost Entirely on Sales.** In reviewing the assessment by the department of revenue, which was based on an apportionment of 90% of Sjong's income to Alaska, the superior court said at oral argument:

> I can't understand how the State of Alaska can take ninety percent. I don't think the port-day's formula (sic), as a matter of fairness, fits the circumstances of this case, or these cases. That comes from a different context, from freighters

14. Had the department applied a port days approach to the payroll factor as well as the property factor, as required by the hearing examiner's decision, the percentages of income attributed to Alaska would have been 85% in 1972, 68% in 1971 and 71% in 1970.

> that pick up in one place and deliver in another but don't have activity out there in international waters, high seas as you say .... You can tax them, but not ninety percent.
>
> ...
>
> I don't think the port-days thing fits, per se; and you're going to have to consider maybe not all of the layup time, but a meaningful fraction of the layup time for the work that's done on the vessel each year, and for the gear, as part of the formula, as part of the port-days. And you might even have to consider the fishing time, as such, as days not attributable to Alaska circumstances.
>
> Somewhere otherwise, it seems to me, would be a fair formula.[15]

But, before the superior court's final decision was issued, this Court issued its decision in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), holding that a single-factor apportionment formula used by Iowa, based only on sales, did not per se violate the commerce clause. After reviewing *Moorman*, the superior court held that the decision of the department of revenue was not in error. The Alaska Supreme Court affirmed.

a. **A Newly Tailored Apportionment Method for One Class of Taxpayers Is Different from the Uniform, Longstanding Formula Upheld in *Moorman*.** The courts below erred in applying *Moorman*, which presented significantly different facts from this case. First, the single-factor sales formula used in

15. Transcript of Argument on Appeal at 5-6.

Iowa was applied uniformly to all taxpayers. The three-factor formula applied in this case was designed especially in response to this appeal for application to nonresident fishermen who are engaged in interstate commerce, and its application not incidentally attributes a much higher share of income to Alaska than would the standard three-factor formula.[16] In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a unanimous Court observed:

> A tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect upon interstate commerce.

Id. at 288-89 n.15.

The hearing examiner in this case decided that apportionment was required and that the department of revenue could not attribute 100% of the income of

16. By any measure of business activity, an attribution of 90% of Sjong's income to Alaska is unreasonably high. Sjong's vessel comes into port in Alaska to deliver crab only twenty to thirty times a season, usually remaining in Alaska only one day for that purpose. The vessel is on the high seas fishing for about five to fifteen days between deliveries. The vessel averages well over 120 days per year in Seattle, where Sjong's business is based and the rest of his property is located. Under the standard three-factor formula, in consideration of where the taxpayer's property is located throughout the year, nearly all of his income is attributable to his domicile and the vessel's home port in Washington.

A service-days approach, as suggested by the appellant, would consider the time spent fishing (the primary income-earning activity), and even if interpreted to exclude much of the time spent in port in Washington, as urged by Alaska, the income apportioned to Alaska would still be substantially less than 20%.

The portion attributed to Alaska under the department of revenue computation of port days was 78.2% for 1972, 57.7% for 1971, and 59.6% for 1970. Under Alaska Stat. § 43.20.071 currently in effect, the port-days approach is applied to all three factors, including sales. The percentages under a strict port-days approach are also substantially lower than the apportionment the department of revenue has applied.

Even if the department's port-days approach were applied only to property and payroll, as contemplated by the hearing examiner, the income attributed to Alaska would be 85% in 1972, 68% in 1971, and 71% in 1970. These measures of appellant's activity all illustrate that the apportionment of 85-92% of Sjong's income to Alaska is not reasonably related to his business activities in Alaska.

nonresident fishermen to Alaska based solely on deliveries in Alaska. But the apportionment formula especially devised for this case comes very close to accomplishing the same thing. It attributes 90% of the income of such fishermen to Alaska by focusing all three factors on deliveries in Alaska and ignoring the substantial business activities of the fishermen while fishing and in their home state of Washington.

b. **The Apportionment in This Case Discriminates Against Nonresident Fishermen Engaged in Interstate Commerce and Presents the Risk of Multiple Taxation.** The department of revenue tailored formula discriminates against nonfishermen who deliver fish to Alaska ports. The income of those fishermen is taxed in Alaska at 90% of the level applied to Alaska resident fishermen. In addition, a fisherman residing and based in Washington is taxed by his own state,[17] while Alaska resident fishermen not doing business in other states pay no state taxes outside of Alaska. The result is a heavier tax burden on nonresident fishermen who do business on an interstate basis. As this Court has recently reemphasized:

> One of the fundamental principles of Commerce Clause jurisprudence is that no State, consistent with the Commerce Clause, may "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."

Maryland v. Louisiana, 49 U.S.L.W. 4562, 4570 (U.S. May

17. Washington raises its revenues by a variety of taxes other than an income tax. *See*, e.g., Wash. Rev. Code, tits. 82 and 84, imposing excise and property taxes. The State of Alaska does not impose sales or property taxes.

26, 1981) (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S 450, 458 (1959)).

In defending its apportionment formula, the department of revenue relied entirely on the fact that Washington imposes no income tax. The fisherman's domiciliary state has the clear power to tax his income, *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 347 & n.8 (1954). No one has ever suggested that Washington would accept an apportioned share of only 10% of the income of fishermen based in Washington who conduct the significant activities here shown in the record. Washington's fairly apportioned share of the income earned by such fishermen substantially exceeds the minor percentage left untaxed by Alaska, and duplicative taxation of income would occur if Washington had an income tax. Alaska's reliance on the fact that Washington raises its revenues by taxes other than an income tax (taxes paid by these fishermen) does not protect its unfairly apportioned tax on income from constitutional challenge. The risk of multiple taxation is sufficient to place Alaska's tax in violation of the commerce clause and to deny to these taxpayers due process and the equal protection of the laws. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980).[18] Review of an apportionment formula is necessary where the danger of multiple taxation exists. *General Motors*

18. In considering the constitutionality of a Vermont tax on dividend income where the taxpayer's domicile of New York imposed no present tax on the dividends, this Court said: "We agree with Mobil that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy." *Mobil Oil Corp. v. Commissioner of Taxes, supra*, 445 U.S. at 444. Similarly, Alaska's apportionment of nearly all Sjong's income to itself cannot be sustained merely because it is the policy of Washington, Sjong's state of residence, not to impose an income tax.

Corp. v. District of Columbia, 380 U.S. 553, 556-57 & n.9 (1965).

3. **Attribution of 90% of the Income of Washington-Based Fishermen to Alaska Is Out of All Appropriate Proportion to the Less Than 5% of Their Business Conducted in Alaska.** The reliance of the courts below on *Moorman* is also misplaced because *Moorman* was limited to a finding that a single-factor apportionment formula based on sales did not violate constitutional standards per se. *Moorman* did not consider whether the single-factor formula as applied violated due process, because the taxpayer made no showing in that regard. In contrast, Sjong has shown that most of his income-earning activities occurred outside of Alaska and that his business activity in Alaska was limited to delivering crab caught outside Alaska to Alaska ports.[19] The question addressed by the Alaska Supreme Court was whether, "since more than 95% of his business activity is conducted outside of Alaska, a formula which allocates approximately 85-92% of his income to the state is manifestly unfair." 622 P.2d at 977, *reprinted in* Appendix D at D-19. *See also id.* at 978, *reprinted in* Appendix D at D-20. Relying on the "heavy burden" placed on the taxpayer "to prove by 'clear and cogent evidence' that the income attributed to the state is 'out of all appropriate proportion to the business transacted . . . in the State,' or has 'led to a grossly distorted result,' " the Alaska court

19. See the summary of activities in Appendix J, *reprinted from* Appendix I to appellant's reply brief filed with the Alaska Supreme Court.

upheld the result below. *Id.* at 976, *reprinted in* Appendix D at D-16.

In reviewing commerce clause challenges to state taxes, this Court's goal has been to "establish a consistent and rational method of inquiry," focusing on "the practical effect of a challenged tax." *Mobil Oil Corp. v Commmissioner of Taxes*, 445 U.S. 425, 443 (1980); *accord, Commonwealth Edison Co. v. Montana*, 49 U.S.L.W. 4957, 4959 (U.S. Jul. 2, 1981). The four-part test in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), is the most frequently cited summary of the necessary analysis. In order to be sustained, a tax must (1) be applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the State.[20] *Id.* at 279. *See also Washington Revenue Dept. v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 750 (1978).

The test under the due process clause of the fourteenth amendment is not dissimilar. The due process clause imposes two requirements for state taxation: (1) a "minimal connection" or "nexus" between the interstate activities and the taxing state, and (2) "a rational relationship between the income attributed to the State and the

20. This Court's decision in *Commonwealth Edison Co. v. Montana*, 49 U.S.L.W. 4959 (U.S. Jul. 2, 1981), diminishes the importance of the relationship-to-services argument when it is imposed on what are clearly in-state values. In this case, however, the tax is imposed upon 90% of appellant's income even though most of that income is earned by activities outside Alaska. The services provided by Alaska to these fishermen are very limited and bear no fair relationship to a tax on 90% of their income. These fishermen reside, base their businesses, and draw primarily upon the services of the state of Washington.

intrastate values of the enterprise." *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980). *See Moorman Mfg. Co. v. Bair, supra*, 437 U.S. 267, 272-73 (1978); *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967); *Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 325 (1968). The tax cannot be "out of all appropriate proportion to the business transacted by the appellant in that State." *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

To uphold an apportionment formula in this case that attributes 90% of income to Alaska when the taxpayer conducts 95% of his business outside Alaska would render meaningless the constitutional standards enunciated by this Court. It would be hard to present a more extreme result than the one upheld by the court below. In *Hans Rees'* this Court concluded that a formula that produced a tax on approximately 80% of the taxpayer's income, when only 17% of that income had its source in the state, was an invalid assessment under the due process and equal protection clauses of the fourteenth amendment. The distortion in this case exceeds that in *Hans Rees'*.

In *Norfolk & Western R. Co. v. Missouri Tax Comm'n, supra*, the mechanical application of a "familiar mileage formula authorized by the Missouri statute" was held to have produced a "grossly distorted result." 390 U.S. at 320, 326. The formula attributed 8% of the railroad's rolling stock to Missouri, whereas the railroad's inventory showed the figure should have been 3%. The resulting

assessment was struck down as violating due process and the commerce clause.

Similar relief from the assessment imposed by Alaska should be granted in this case. The apportionment at issue is based on a tailored formula, requiring strict scrutiny. The tax discriminates against nonresidents conducting their business on an interstate basis. And the proportion of income attributed to Alaska is grossly excessive as compared with the business transacted by Sjong in Alaska.

CONCLUSION

Appellant is entitled to summary reversal of the decision of the Alaska Supreme Court based on a finding either that Alaska has no jurisdiction to tax, or, if any tax is appropriate, that the apportionment applied attributes income to Alaska out of all appropriate proportion to the business transacted there.

If summary relief is not granted to appellant, the Court should allow the submission of briefs on the merits and oral argument.

DATED: September 2, 1981.

Respectfully submitted,

DOUGLAS M. FRYER, of Moriarty, Mikkelborg, Broz, Wells & Fryer

WILLIAM B. ROZELL, of Faulkner, Banfield, Doogan & Holmes

Attorneys for Appellant.

Appendix A

IN THE SUPREME COURT
OF THE STATE OF ALASKA

JOHN K. SJONG,	)
	)
Appellant,	)
	)
v.	)
	)
STATE OF ALASKA,	)
	)
Appellee.	)
	)

Supreme Court No. 4255

ORDER

Before: Rabinowitz, Chief Justice, Connor, Burke, and Matthews, Justices. [Compton, Justice, not participating].

On consideration of the petition for rehearing filed February 17, 1981,

IT IS ORDERED:

The petition for rehearing is denied.

Entered by direction of the court at Anchorage, Alaska, on June 4, 1981.

CLERK OF THE APPELLATE COURTS

Robert D. Bacon

ccs: Justices
Counsel

Appendix B

THE SUPREME COURT OF THE STATE OF ALASKA

JOHN K. SJONG	)	
	)	
Appellant,	)	File No. 4255
	)	
v.	)	
	)	
STATE OF ALASKA, DEPARTMENT OF REVENUE,	)	
	)	MANDATE
	)	
Appellee.	)	
	)	

TO: Superior Court of the State of Alaska,
First Judicial District at Juneau.

John K. Sjong filed an appeal from an order of the Superior Court, First Judicial District at Juneau in Civil action no. 77-66 entited, "JOHN K. SJONG, Appellant, vs. STATE OF ALASKA, DEPARTMENT OF REVENUE, Appellee". The case was heard by this court on October 4, 1979. On January 23, 1981, the court filed its written opinion. Appellant's petition for rehearing was denied by this court on June 4, 1981.

IT IS ORDERED:

The Order of the Superior Court, entered on August 16, 1978, is affirmed.

Appellee shall recover from Appellant attorney fees in the amount of $500.00.

Entered by direction of the Court and pursuant to Appellate Rule 507 at Anchorage, Alaska, on June 5, 1981.

CLERK OF THE SUPREME COURT

SEAL

Robert D. Bacon

Appendix C

THE SUPREME COURT FOR THE STATE OF ALASKA

JOHN K. SJONG,	)	
	)	
Appellant,	)	File No. 4255
	)	
v.	)	
	)	Opinion No. 2269
	)	
STATE OF ALASKA, DEPARTMENT OF REVENUE,	)	
	)	
	)	
Appellee.	)	
	)	

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

PLEASE TAKE NOTICE, and notice is hereby given, that appellant John K. Sjong hereby appeals to the Supreme Court of the United States from the final judgment of this court dated January 23, 1981 affirming the judgment of the trial court, from the order denying the petition for rehearing dated and entered June 4, 1981, and from the mandate dated and entered June 4, 1981, and from the whole thereof.

This appeal is taken pursuant to Title 28, U.S.C. § 1257(2).

QUESTIONS PRESENTED

Appellant is a nonresident commercial fisherman who sells crab caught exclusively in international waters according to prearranged contracts negotiated outside the taxing state. Except for incidental stops, appellant's only contact with the taxing state occurs when he comes into port to deliver his catch.

1. Does the state lack the sufficiently substantial nexus to appellant's activities required by the commerce clause and the due process clause of the Fourteenth Amendment to tax his net income derived from such sales?

2. Do 15 U.S.C. § 381 and the supremacy clause prohibit state taxation of the net income derived from such sales where the only stage of the transactions occurring within the taxing state is "delivery from a point outside the [s]tate"?

3. Is an allocation to the taxing state of 85-92% of net income derived from such sales a fair apportionment under the commerce clause and the due process clause of the Fourteenth Amendment, where appellant conducts only a small percentage of his business activity within the taxing state?

DATED this 9th day of July, 1981.

DOUGLAS M. FRYER, of Moriarty, Mikkelborg, Broz, Wells & Fryer

WILLIAM B. ROZELL, of Faulkner, Banfield, Doogan & Holmes

Attorneys for Appellant

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 13th day of July, 1981, a true and correct copy of Notice of Appeal to the Supreme Court of the United States was served by mail on the following attorneys:

John G. Gissberg
Assistant Attorney General
State of Alaska
429 "L" St., Suite 100
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Attorney General's Office
State of Alaska
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Juneau, AK 99822

Faulkner, Banfield, Doogan & Holmes

By _____
William B. Rozell

Appendix D

THE SUPREME COURT OF THE STATE OF ALASKA

JOHN K. SJONG, Appellant, v. STATE OF ALASKA, DEPARTMENT OF REVENUE, Appellee.	File No. 4255 OPINION [No. 2269 – January 23, 1981]

Appeal from the Superior Court of the State of Alaska, First Judicial District, Juneau, Thomas B. Stewart, Judge.

Appearances: Douglas M. Fryer, Moriarty, Mikkelborg, Broz, Wells & Fryer, Seattle, and William B. Rozell, Faulkner, Banfield, Doogan & Holmes, Juneau, for Appellant. Joseph K. Donohue, Teo C. Spengler, Assistant Attorney Generals, Avrum M. Gross, Attorney General, Juneau, for Appellee.

Before: Rabinowitz, Chief Justice, Conner, Burke and Matthews, Justices. (Boochever, Justice, not participating.)

BURK, Justice.

This case involves the constitutionality of the Alaska Net Income Tax Act, AS 43.20.010–.350, as applied to non-resident crab fishermen who fish off the coast of Alaska in international waters and sell their catch to Alaska processors. Appellant John K. Sjong, on behalf of eleven other Washington

State fishermen, claims that the State of Alaska has nor jurisdiction to tax his net income, and that to do so would violate the due process and commerce clauses of the United States Constitution, and section 381 of the Interstate Income Act.[1]

John K. Sjong is a commercial king crab fisherman who resides in the State of Washington. He has fished commercially for at least ten years, and for eight of those years he has owned and operated his own fishing vessel. His fishing vessel is licensed, registered, and harbored in Washington with Seattle as its designated home port. He fishes exclusively in the international waters surrounding Alaska[2] and sells his catch only to Alaska processors and canneries.

In preparation for the fishing season, Sjong outfits his vessel and hires a crew in Seattle. Most of the crew members are Washington residents, but should a crew member quit or become sick during the season, emergency replacements will be hired in Alaska. Provisions are also taken on in Washington. Although Sjong tries to take enough food and fuel to last the entire voyage, he often purchases fresh food and extra fuel while in port in Alaska.

Prior to journeying to the fishing grounds, Sjong negotiates a market and a price for his catch in Seattle with representatives of various processing companies. Once the fishing season starts, Sjong will come into an Alaska port once every ten to fifteen days to deliver his catch to a processing plant. At that time, possession as well as risk of loss and title is transferred from the fisherman to the processors. Payment for the catch is made in Seattle after the fishing season has ended.

Depending upon the extent of his catch, Sjong will make anywhere from twenty to thirty trips into port each season to sell his crab. While in port, he obtains supplies which enable him

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1. 15 U.S.C. § 381 (1976).

2. Sjong testified at the revenue board hearing that he operates his fishing vessel between 5 and 150 miles from the coast line of Alaska. As provided by 43 U.S.C. § 1312 (1976), a state "may extend its seaward boundaries to a line three geographical miles distance from its coast line."

to continue his fishing activities; the most important being bait which is purchased from the local canneries and processors. Sjong also enters Alaska ports to obtain emergency medical treatment for sick or injured crew members, or to have emergency repairs performed on his equipment. The ports are also open to his vessel in case shelter is ever needed from storms.

On October 10, 1974, the Alaska State Department of Revenue notified Sjong that they had assessed his personal net income tax for the years 1970, 1971, and 1972, and that he owed $32,481.89 in unpaid taxes. Pursuant to AS 43.20.280,[3] Sjong applied for a hearing on the matter. The Department concluded that Sjong had sufficient minimum contracts with the state to be subject to the net income tax statutes, that his activities in the State were not exempt from taxation under the Interstate Income Law, and that the exact amount of his tax would be determined by the apportionment formula provided

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3. As 43.20.280 (repealed in 1976) provided:

> (a) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department within 60 days from the date of the notice required to be given to him by the department, giving notice of the grievance, and request a hearing. At the hearing the department may subpoena witnesses and may administer oaths and make inquiries necessary to determine the amount of the tax due to the state, and if a correction is warranted, the department shall make the correction after the hearing.
>
> (b) Within 30 days after hearing and decision by the department, the taxpayer may file a complaint in the superior court in the judicial district in which he resides, naming the department as defendant, setting out the facts, and stating reasons why the action is erroneous, and praying relief from it, and the clerk of the court shall issue summons in the regular manner. . . .

AS 43.20.280 was repealed in 1976 by ch. 166, § 3, SLA 1976 and has been replaced by AS 43.05.240. A number of changes in the tax law were made in 1976, but since this case was initially brought under the old tax statutes, those statutes then in effect will govern the resolution of this matter.

for in the state tax statutes. Sjong appealed the Department's decision to the superior court; again, all issues were resolved against him and the taxation was upheld.

In this appeal he raises four arguments in opposition to the taxation of his net income: (1) the tax violates the fourteenth amendment due process clause; (2) the tax violates the commerce clause; (3) the tax violates section 381 of the Interstate Income Act; and (4) the apportionment formula employed by the state results in an unfair allocation of his income.

I. DUE PROCESS

The first issue on appeal is whether the taxation of Sjong's net income constitutes a taking of property without due process of law. The fourteenth amendment due process clause[4] limits states from extending their powers of taxation beyond their borders. As such, any attempt to tax extra-territorial values would be an unconstitutional taking of property. In order for a state to constitutionally tax a non-resident, the non-resident must be "sufficiently involved in local events to forge 'some definite link, some minimum connection' sufficient to satisfy due process requirements." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 465, 3 L.Ed.2d 421, 431 (1959), quoting Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-45, 98 L.Ed. 744, 748 (1954). John Sjong contends

4. The due process clause of the fourteenth amendment provides:

> Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. Const. amend. XIV, § 1.

that his contacts with the state are so minimal that there is an insufficient nexus upon which to base a tax.

In determining what constitutes sufficient minimum contacts for the purposes of taxation, the Supreme Court has adopted the following basic test first stated in Wisconsin v. J.C. Penney, Co., 311 U.S. 435, 85 L.Ed. 267 (1940): "That test is . . . whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." 311 U.S. at 444, 85 L.Ed at 270-71 (emphasis added). As we stated in North Slope Borough v. Puget Sound Tug & Barge, 598 P.2d 924, 928 (Alaska 1979):

> Due process requires that a tax be related "to opportunities, benefits, or protection conferred or afforded" by the taxing authority and such a relationship exists "if the tax is fairly apportioned to the commerce [there] carried on." Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 174, 93 L.Ed. 585, 589 (1949).

Therefore, our task is to determine whether the protections, opportunities, and benefits given to Sjong by the state provide a sufficient nexus to uphold the taxation of his net income.[5]

As the record in the case indicates, Sjong makes approximately twenty to thirty trips per season into various Alaska ports to sell and deliver his catch of crab to processors and canneries. While in port, Sjong purchases any and all needed supplies and, among other things, makes use of emergency services when necessary.

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5. In previously decided cases, contacts which were adjudged to be sufficient to uphold taxation included: maintaining a leased office and several salesmen within a state to solicit orders, Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 3 L.Ed.2d 421 (1959); registering as a corporation to do business within a state, Wisconsin v. J.C. Penney, Co., 311 U.S. 435, 85 L.Ed. 267 (1940); and maintaining a sales service office in the state which served five other states, Williams v. Stockham Valves & Fittings, Inc., 358 U.S. 450, 3 L.Ed.2d 421 (1950). See also the cases cited in note 15 infra.

Sjong argues that all of the services and benefits alluded to by the state are available to any person who travels interstate and should not be the basis for the imposition of a tax. What must be recognized, however, is that unlike the services rendered to an ordinary traveler, the services, benefits, and protections offered to Sjong are directly related to generating his income. Without the opportunity to purchase fresh bait and supplies, he would be severely hampered in his ability to continue his fishing ventures. Further, the availability of emergency medical services, repair facilities, and crew replacement in Alaska clearly benefits his business operations, as does the opportunity to sell his crab without the expenditure and delay of a length trip.

It is precisely this notion, that the benefits afforded to the taxpayer are directly related to "business income generation," which is central to a resolution of this issue. In Alaska v. Petronia, 418 P.2d 755 (Wash. 1966), the Washington State Supreme Court applied this concept in upholding Alaska's taxation of the net income of a nonresident seaman employed on a vessel in Alaskan waters.

As in the instant case, the Washington Supreme Court was faced with the question of whether Petronia had sufficient minimum contacts with the State of Alaska so that taxation of his income would not violate due process. By applying the business income generation concept, the court determined that there were sufficient contacts to justify imposition of a net income tax.

> The defendants argue that . . . the benefits afforded seamen are de minimus; . . . that virtually the only benefits available from the state of Alaska to seamen such as the defendants are the protection and benefits they are afforded by the state when they are on shore in strictly a tourist or recreational capacity.
>
> This argument . . . is impressive; however, it overlooks a most significant element considered in applying the test of benefits in determining minimum connections. Probably the most significant benefits in the eyes of these defendant seamen are the wages

> they contemplated receiving for their services during the course of the vessel's voyage. The business productivity generated by Alaska was accountable for the wages earned by the defendants when they were in Alaskan waters.

418 P.2d at 758.

The court went on to conclude: "We are satisfied that the benefits of employment afforded by this economic activity of the state of Alaska constituted minimum connections within the rule to avoid a denial of due process under the Fourteenth Amendment to the United States Constitution." Id. at 759.

Similarly, the state in this case has argued that Sjong is also a direct beneficiary of the economic activity of the state. As Sjong testified, he fishes only off the Alaska coast and sells exclusively to Alaska processors. His income is derived solely from the market Alaskan canneries and processors provide for his fishing skills. Indeed, his crab fishing might be rendered totally uneconomic if he were foreclosed from selling to Alaskan processors and had to return to Seattle to sell his catch.

The main distinction between the instant case and the situation described in the Petronia case is that Petronia earned his income while employed on a vessel in Alaskan waters. Here, Sjong catches crab outside of Alaska in international waters and then sells them within the state. We do not believe this distinction presents a significant difference, for even though Sjong fishes in international waters, the activities of the state have a substantial effect on his activities. As the state has pointed out, the particular industry which Sjong is involved in, the crab industry, has been fostered by the policies of the state and protected by its various police powers. See State v. Bundrant, 546 P.2d 530 (Alaska 1976), rehearing denied, 547 P.2d 838 (Alaska 1976).[6]

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6. In State v. Bundrant, we upheld certain state laws and regulations relating to crab fishing beyond the three-mile state jurisdictional limit in the Bering Sea on the grounds that the State had a legitimate objective in regulating the taking of crab outside the State in order to conserve the crab resources existing within the State. Id. at 554.

What is of primary significance in determining the legality of the tax is whether the income was derived from sources in the state. As 43.20.035(a) states that the income of non-residents is taxable income when it is "attributable to sources in the state." Since Sjong's income is derived from the sale of crab to Alaska processors, that income should be subject to the income tax. Where the crab were actually caught makes no difference.

Sjong also contends that income is earned where the skill is employed to earn that income. In Petronia, for example, that portion of Petronia's work performed while his ship was in Alaskan waters was considered to have been income earned and taxable in Alaska. Applying the same reasoning, Sjong claims that since the labor to catch the crabs was employed in international waters, no taxable income can be attributed to the state. This argument, however, fails to draw a distinction between income which is the direct result of an individual's labor, and income derived from the sale of goods, such as crab. Absent a sale, the skill and labor used to catch crab would result in no profit or income to the individual.

In Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U.S. 271, 69 L.Ed. 282 (1924), the United States Supreme Court upheld a state franchise tax assessment based on sales within the State of New York by a British corporation that manufactured ale outside the state. The corporation argued that because it was not incorporated in New York and did not maintain its principal place of business there, New York could not levy a tax merely by reason of its having sales in the state. The Supreme Court said that where "its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York . . . –the process of manufacturing resulting in no profits until it ends in sales, –the state was justified in attributing to New York a just proportion of the profits." 266 U.S. at 282, 69 L.Ed. at 287. Similarly, the

process of fishing results in no profits until the catch is sold to processors in Alaska.[7]

Sjong also argues that the actual sale of the crab catch takes place in Washington, i.e., the contract is negotiated in Washington and payment is made there. The only sale-related activity occurring in Alaska is the delivery of the goods, and delivery alone should not subject him to taxation. In support of this he cites the Supreme Court's decision in Miller Brothers Co. v. Maryland, 347 U.S. 340, 98 L.Ed. 744 (1954), where the Court held that a Delaware store could not be held liable for Maryland use taxes on merchandise sold to Maryland residents because of a lack of minimum contacts. The only contact that the store had with the taxing state was that its truck occasionally entered the state to deliver the previously ordered goods. Sjong argues that since his boat enters the state only to make deliveries, this should not constitute a sufficient nexus to uphold taxation.

The situation in Miller Brothers is to be distinguished from the case at bar. First, in Miller Brothers the delivery truck entered the state sporadically; it did not make all deliveries. All sales were made outside the state, and the sales made to Maryland residents constituted only a portion of the total of Miller Brothers' overall sales. Here, the taxpayer admits that he has been fishing in Alaska for ten years, and sells exclusively to Alaska processors. His principal source of income is the money which he receives in payment for crab delivered to those processors. The amount of business activity is certainly more substantial than that in Miller Brothers.

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7. In the alternative, Sjong argues that no income is earned until payment is made and since all payments were made in Seattle, no income should be attributed to the state. Various courts have held, however, that the actual place where income payments are turned over to the taxpayer is not determinative of the source of the income for purposes of state income tax. See Petition of Union Elec. Co. of Mo., 161 S.W.2d 968, 972 (Missouri 1942); In re Kansas City Star Co., 142 S.W.2d 1029, 1039 (Missouri 1940). Furthermore, a taxpayer cannot escape a tax on income from sources within the state by billing from the outside or by setting up his machinery so that the income is paid to him in another state. Gross Income Tax Div. v. Bartlett, 93 N.E.2d 174, 177 (Ind. 1950).

Second, more than "mere delivery" of goods is taking place within Alaska. What in fact is occurring is the consummation of the sale of Sjong's crab. AS 43.20.130(e)(1)[8] states that "[s]ales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser . . . inside this state . . ." Therefore, a sale has taken place when the crab are delivered to the processor in Alaska under a previously negotiated contract.[9]

In conclusion, because the state is giving something for which it can ask a return, in the form of supplies, employment, and a market for sale of goods, and the taxed income is derived from sources in the state, there appears to be a sufficient nexus to justify imposition of the tax.

II. COMMERCE CLAUSE

The commerce clause of the United States Constitution[10] places restraints upon the taxing power of states similar to those of the due process clause. In fact, these two constitutional

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8. As 43.20.130(e) repealed by ch. 70, § 13, SLA 1975. However, since this case was instituted under the prior tax sstatutes, those statutes then in effect will govern the resolution of this matter.

9. Under the Uniform Commercial Code the trans action which occurs in Alaska constitutes a sale. UCC § 2-106(1) provides that a "sale consists in the passing of title from the seller to the buyer for a price." Commenting on this section one authority states: "The transfer of title is the essential element or the distinguishing characteristic of a sale of goods." R. Anderson, Uniform Commercial Code § 2-106, § 2-106:5 at 235 (2d. ed. 1970). In testimony before the Department of Revenue, Sjong's attorney said: "I think for the purposes of what we're discussing, the risk of loss passes at the time the crab is delivered. So I would say that title of the crab is with the vessel until such time as it is delivered to the processor."

10. The commerce clause is set forth in article I of the United States Constitution: "The Congress shall have the power to . . . regulate commerce with foreign nations, and among the several states and with the Indian tribes;. . . U.S. Const. art. I, § 8.

limits overlap to a great extent. The courts, however, have usually placed considerations of minimum contacts and sufficient nexus under the due process heading, while questions regarding the proper apportionment of income to the taxing state and the discriminatory impact of taxes are covered by the Commerce Clause. Central Greyhound Lines v. Mealey, 334 U.S. 653, 661, 92 L.Ed. 1633, 1640 (1948). See also Moorman Manufacturing Co. v. Bair, 437 U.S. 267, 277-79, 57 L.Ed.2d 197, 207-08 (1978). Hence, "net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the [tax]." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 3 L.Ed.2d 421, 424 (1959).

The test used by the United States Supreme Court to determine the validity of a tax under the Commerce Clause was recently expressed in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 51 L.Ed.2d 326, 331 (1977). There, four factors were analyzed to determine the validity of the tax: (1) whether the activity taxed had a sufficient nexus with the taxing state; (2) whether the tax is fairly related to benefits provided by the state to the taxpayer; (3) whether the tax was fairly apportioned to local activities; and (4) whether it discriminated against interstate commerce. As the nexus consideration and questions of the relationship to services provided by the state has been dealt with in the previous due process discussion supra, and the apportionment question will be discussed infra, the only issue which we will consider here is whether the tax discriminates against interstate commerce.

A state may not "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business" [relative to interstate business]. Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 329, 50 L.Ed.2d 514, 524 (1977), quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458, 3 L.Ed.2d 421, 427 (1959). There appears to be no indication

that this situation is present here. As neither party has briefed this argument, this point will not be considered[11] and whether the commerce clause will be violated by imposition of the state net income tax should be determined in light of the other overlapping areas of discussion.

III. INTERSTATE INCOME LAW EXEMPTION

Sjong's third argument in support of this contention that there is no jurisdiction to tax him is that the State is prohibited from taxing his activities under section 381(a) of the Interstate Income Law.[12] Public Law 86-272 was enacted in 1959 as a congressional limitation on the Supreme Court's decision in the Northwestern States case,[13] in response to a tremendous outcry from interstate business who saw themselves potentially subject to numerous state and local taxes.[14]

The pertinent part of section 381 states:

> Imposition of net income tax
>
> Minimum standards
>
> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities

11. Where a point is not given more than a cursory statement in the argument portion of a brief, such point will not be considered by the supreme court. Lewis v. State, 469 P.2d 689 (Alaska 1970). See also Kristich v. State, 550 P.2d 796 (Alaska 1976); Miller v. City of Fairbanks, 509 P.2d 826 (Alaska 1973).

12. Pub. L. 86-272, codified at 15 U.S.C. §§ 381-384 (1976).

13. 358 U.S. 450, 3 L.Ed.2d 421 (1959).

14. See S. Rep. No. 658, 86th Cong., 1st Sess., reprinted in [1959] U.S. Code Cong. § Ad. News 2548, 2549-50.

> within such State by or on behalf of such person during such taxable year are either, or both, or the following:
>
> (1) the solicitation of orders by such person, or his representative, in such State for sales or tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State . . .

The only case in which the United States Supreme Court has interpreted the Interstate Income Law is apparently Heublein, Inc. v. South Carolina Tax Commission, 409 U.S. 275, 34 L.Ed.2d 472 (1972). The holding of that case, however, actually had very little to do with section 381. Heublein concerned a South Carolina liquor regulation and the interaction between that regulation, section 381, and the twenty-first amendment to the United States Constitution.[15] The Court concluded that even though the regulation required an interstate business to undertake activities within the taxing state which would take it beyond the ambit of section 381 protection, the state was not deliberately attempting to structure its regulations so as to justify imposition of a tax. The regulation was held valid and "§ 381 does not apply." 409 U.S. at 284, 34 L.Ed.2d at 480.

Of the lower court cases which have interpreted Public Law 86-272, practically all have been concerned with interpretation of the word "solicitation." The strongest line of cases comes from decisions of the Oregon Supreme Court. The first case, Smith, Kline & French Laboratories v. State Tax Commission, 403 P.2d 375, 377 (Ore. 1965), interpreted the term broadly by holding that it included all "lesser, included phases" of solicitation, such as pre-solicitation promotional work, so that such activities alone would not cause an interstate business

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15. The twenty-first amendment gives to the states power to regulate sales of alcoholic beverages. Section 2 of the amendment provides that "[t]he transportation or importation into any State . . . for delivery or use therein ofintoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S. Const. amend. XXI.

to lose its section 381 exemption. The Oregon Supreme Court has, however, in subsequent decisions, significantly narrowed its interpretation of this key term, and has excluded from interstate tax exemption any activities not directly leading to the placing of orders.[16]

Sjong contends that because his activities in the state consist solely of the delivery of goods previously ordered under contracts negotiated outside of the state, he should be exempt from taxation. He argues that section 381(a) should not be read so narrowly as to require all those activities described in the section to be present for exemption from taxation. He relies heavily on Smith, Kline to support this view. However, as the Oregon court's interpretation of the basic holding of Smith, Kline has narrowed considerably, we feel his reliance on a board construction of section 381(a) is untenable.

In their decisions, the superior court and revenue board held that in order for an interstate business to qualify for a section 381(a) exemption, the business activities must conform strictly to the language of the statute. We agree with this interpretation of section 381(a); that in order to qualify for the exemption, a business must solicit orders, which are sent out of state for approval, and then make deliveries into the state. Since Sjong's acts concern only the third part of the described activity – deliveries – it does not come within the statutory exemption.

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16. For example, in Olympia Brewing Co. v. Dep't of Revenue, 511 P.2d 837 (Ore. 1973), cert denied, 415 U.S. 976 (1974), the presence of beer kegs by which retailers could dispense draft beer destroyed the section 381(a) exemption and was sufficient to justify imposition of the state corporation income tax. Other activities which the court found went beyond solicitation included: replacing and servicing damanged merchandise, Miles Laboratories, Inc. v. Dep't of Revenue, 546 P.2d 1081 (Ore. 1976); holding consultations and contracts for sale of goods, Iron Fireman Mfrg. Co. v. State Tax Comm'n, 445 P.2d 126 (Ore. 1968); and collection by salesmen of initial deposits on merchandise, Herff Jones Co. v. State Tax Comm'n, 430 P.2d 998 (Ore. 1967). For a discussion on the Oregon line of cases, see Hartman, "Solicitation" and "Delivery" Under Public Law 86-272: An Uncharted Course, 29 Vand. L. Rev. 353, 364-77 (1976).

Looking at the original legislative intent, this would seem to be a correct interpretation. As the bill was originally passed to cover the types of activities litigated in the Northwestern States case, and the activities there consisted of in-state solicitation coupled with out-of-state approval and delivery, the mere act of delivery should not be sufficient to bring an interstate business within the scope of section 381(a) coverage. In fact, the Senate Report specifically states, "[t]o qualify, hwoever, all such orders must be sent outside the State for approval or rejection, and if approved, must be filled by shipment or delivery from a point outside the State."[17] This seems to indicate exactly what types of activities were intended to be protected by the bill. To interpret Sjong's activities as falling within the exemption of section 381(a) would controvert the legislative intent.

Furthermore, what is occurring in the case at bar is not the mere delivery of goods, but also the sale of tangible personal property within the state, and such sales are not covered by the section 381(a) exemption either. In conclusion, Sjong's activities go beyond the solicitation and delivery requirements of section 381, and are not exempt under the Interstate Income Law.

IV. THE APPORTIONMENT FORMULA

Having determined that the state has jurisdiction to tax Sjong's net income, the next issue we must address concerns the proper apportionment of the tax. Sjong contends that the apportionment formula adopted by the Department results in an unfair allocation of his income to the state.

The purpose of apportionment is to ensure that only activities within the taxing state are subject to taxation. An apportionment formula is valid under the due process and commerce clauses only if, as a tax measure, it assigns to a state income that can reasonably be said to result from activities or properties

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17. [1959] U.S. Code Cong. & Ad. News 2538.

within its borders. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 462, 3 L.Ed.2d 421, 429-40 (1959). In analyzing the apportionment formula, we utilize a two-step process. First, we must address the question of whether the apportionment formula as a whole is constitutional. Second, if it is found to be acceptable, it must then pass the test of fairness as applied to the individual taxpayer's situation. Norfolk & Western Railway Co. v. North Carolina, 297 U.S. 682, 685, 80 L.Ed. 977, 980 (1936).

Concerning the first step, the United States Supreme Court, in reviewing appeals on the proper allocation and apportionment of taxes, has refused to impose strict constitutional restraints on a state's apportionment formula. Recognizing the artificiality of such formulas, the Court states a readiness to sustain any formula reasonably designed to determine the net income attributable to business done in the taxing state. "[R]ough approximation rather than precision" is sufficient. International Harvester Co. v. Evatt, 329 U.S. 416, 422, 91 L.Ed. 390, 395 (1947), citing Illinois Central Railroad Co. v. Minnesota, 309 U.S. 157, 161, 84 L.Ed. 670, 674 (1940). "Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments." International Harvester Co. v. Evatt, 329 U.S. at 422-23, 91 L.Ed. at 395.

Therefore, a heavy burden is placed on a taxpayer challenging a state's allocation of his income to prove by "clear and cogent evidence" that the income attributed to the state is "out of all appropriate proportion to the business transacted . . . in that State," or has "led to a grossly distorted result." Moorman Manufacturing Co. v. Bair, 437 U.S. 267, 274, 57 L.Ed.2d 197, 205 (1978), quoting Hans Rees' Sons v. North Carolina ex rel. Maxwell, 283 U.S. 123, 135, 75 L.Ed. 879, 908 (1931) and Norfolk & Western Railroad Co. v. Missouri Tax Commission, 390 U.S. 317, 326, 19 L.Ed.2d 1201, 1208 (1968).

In the original assessment of the tax, the Department of Revenue relied on Revenue Ruling 74-2[18] which stated:

> It must be remembered that the fishing vessel must have actual business activity in more than one taxing jurisdiction to apportion. The mere fact that a boat winters in Seattle or some other port does not give it nexus in that state . . . If all fish products are taken in international waters and sold in Alaska only, apportionment shall not apply and all income from fishing is to be reported to Alaska. . . .

On the basis of this Ruling, the Department originally refused to apportion Sjong's income and allocated the entire sum to the State. Following Sjong's protest, hearings were held and sufficient contacts with the State of Washington were found to require apportionment. The Department employed the formula outlined in AS 43.20.130(a),[19] resulting in an allocation of approximately 85-92% of Sjong's income to the State for the years in question.

The apportionment formula takes into consideration three factors: Sales, property, and payroll. AS 43.20.130(e)(1) provides that "sales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser . . . inside this state regardless of f.o.b. point or other conditions of the sale . . ." The Department concluded: "The crab are tangible personal property delivered to a purchaser within

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18. Revenue Ruling 74-2, dated February 20, 1974, was promulgated in response to a request from Sjong on the question of the proper allocation and apportionment of income to the state from fishing operations. Revenue Ruling 74-2 is reprinted in [1974] Alaska Tax Reports (CCH) ¶ 200-160.

19. As 43.20.130(a) (repealed ch. 70, § 13, SLA 1975) provided:

> (a) All business income which cannot be directly apportioned and allocated to this state shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Alaska and regardless of the other conditions of the sale (for instance, a market negotiated outside the State) are assignable to Alaska for purposes of the sale factor." Because all of the sales of crab were made in Alaska, 100% of sales was allocated to the state.

Applying the standard provided in AS 43.20.130(g),[20] the property factor was calculated on the basis of the "port-day" method. This consists of a ratio of the number of days spent in ports inside the state to the total number of days spent in ports inside and outside the state. For purposes of fishing vessels, the port-day method excludes idle time between fishing seasons or between charters, but does not include time spent stocking the boat with supplies and readying it for departure on a fishing voyage, cleaning it up after a voyage, and time spent delivering fish and taking on additional supplies during the fishing season.

The hearing examiner noted two alternative means of calculating the payroll factor:

> [W]here the income producing activity is attributable to the operation of a vessel on the high seas as in fishing activities, . . . the payroll of employees engaged in operating the vessels, should be assigned to the State pursuant to the "port day" method . . . [but] where the

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20. AS 43.20.130(g) (repealed ch. 70, § 13, SLA 1975) provided:

> (g) The value of vessels operating on the high seas and compensation of employees engaged in operating the vessels shall be apportioned to the state in the ratio which the number of days sept in ports inside the state bears to the total number of days spent in ports inside and outside the state. The term "days spent in ports" does not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or becuase of seasonal reduction of service. Days in port are computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to, and inside the state and compensation of employees so engaged are apportioned to the state in the ratio which the number of days during which the services are rendered inside the state bears to the total number of days during which the services are rendered inside and outside the state.

> port day method does not reasonably approximate the value of wages accountable for by the business generated by Alaska, the payroll factor should be determined by reference to the corresponding sales of fish or crab.

Relying on the provisions of AS 43.20.130(g), the hearing examiner also apportioned the payroll factor pursuant to the port-day method. However, the Department of Revenue rejected the examiner's calculation and chose to adopt a different means of apportionment. In light of the fact that the earnings of the fishing crew were directly dependent upon the sale of the catch of crabs, the Department calculated the payroll factor on the basis of sales in Alaska, i.e., 100%.

Sjong contends that since more than 95% of his business activity is conducted outside of Alaska, a formula which allocates approximately 85-92% of his income to the state is manifestly unfair. The courts, however, have upheld allocations which take into account income earned outside of the taxing state's borders, so long as the values can be "reasonably attributable" to activities occurring within the taxing state. In Wisconsin v. J.C. Penney, Co., 311 U.S. 435, 445, 85 L.Ed. 267, 271 (1940), the Court said there was nothing unconstitutional about a tax which is contingent upon events brought to pass without a state, so long as there is a nexus between such tax and transactions within a state for which the tax is an exaction. Due process does not prohibit a formula which considers out-of-state activity in evaluating the local activity. International Harvester Co. v. Evatt, 329 U.S. at 423, 91 L.Ed. at 395. So, in the instant case, the mere fact that the sales of crab in Alaska are contingent upon negotiations in Seattle and crab fishing in international waters should not act to invalidate the tax. Our task is not to determine whether this formula is the best method of apportioning income, but merely whether it is fairly calculated to assign to the state that portion of net income reasonably attributable to the business done in the state. This it seems to have done.

The second step is to determine whether the formula as

applied to the individual taxpayer has produced a fair apportionment. The taxpayer has made two challenges to the apportionment scheme. He first challenges the employment of the port-day formula in calculating the property factor, and argues that a voyage-day formula be used in its place. The "voyage-day" formula would apportion the vessel's income on the basis of a ratio of the number of days in the state to the number of days inside and outside of the state. See Luckenbach Steamship Co. v. Franchise Tax Board, 33 Cal. Rptr. 544, 547 (Cal. App. 1963). This, he claims, would take into consideration time spent making repairs on the boat, and negotiating a market for his crab catch; factors which the "port-day" formula does not take into account.

Sjong has not shown that the port-day method results in a gross distortion of his tax. True, he has argued that one formula may be slightly fairer than the other and may better represent his particular activities, but courts do not usually invalidate an assessment unless the tax is "out of all appropriate proportion to the business transacted . . . in that state." Hans Rees' Sons v. North Carolina, 283 U.S. 123, 135, 75 L.Ed. 879, 908 (1931). This he has not shown, and in light of his failure to do so, the employment of the port-day formula should be upheld.

Sjong's second argument is that the Department should not have allocated 100% of the sales and payroll to the state when over 95% of his business activity is conducted outside the state. The statute in question, AS 43.20.130(e)(i) provides that "Sales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser . . . inside this state." All of Sjong's sales are made in Alaska and a 90% allocation of income to the state does not produce a gross distortion. In fact, failure to allocate sales to the state in which they are made would greatly underepresent the extent of the taxpayer's activities within the state.

Finally, under AS 43.20.140,[21] the Department had the

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21. AS 43.20.140 is repealed by ch. 70 § 13, SLA 1975.

discretion to base the payroll factor on sales if it determined the port-day formula did not fully represent the extent of the taxpayer's business activity in the state. Given that Sjong's earnings were dependent upon sales, it is hard to conclude that there was no reasonable basis for its decision.

Because the allocation formula is constitutional on its face, and has not produced a grossly distorted result in the assessment of Sjong's tax liability, we hold the Department's apportionment formula valid.

V. ATTORNEY'S FEES

The final issue in this appeal is whether the superior court abused its discretion in awarding $1,775 to the state for its attorney's fees. Because he had a statutory right to appeal the decision of the taxing authority to the superior court,[22] Sjong contends that the court erred. He relies upon our decision in Crisp v. Kenai Peninsula Borough School District, 587 P.2d 1168 (Alaska 1978).

In Crisp, we reversed an award of attorney's fees against a dismissed tenured teacher in his unsuccessful appeal to the superior court from his employer's decision to terminate his contract.[23] In our opinion, we stated: "Given Crips's statutorily guaranteed right to contest his dismissal in the courts, we think it would be manifestly unreasonable to penalize the exercise of that right by allowing an award of any attorney's fees to the school district." Id. at 1169 (footnote omitted) (emphasis in original).

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22. See note 3, supra.

23. AS 14.20.205 provides tenured teachers a right to judicial review of their termination as follows:

> Judicial review. If a school board reaches a decision unfavorable to a teacher, the teacher is entitled to a de novo trial in the superior court. However, a teacher who has not attained tenure rights is not entitled to judicial review according to this section.

Upon further reflection we realize that our statement in Crisp may be subject to misinterpretation. In that case we were influenced by the importance of the right being asserted. In a very real sense, Crisp's entire future was at stake, due to the damage likely to be done to his professional reputation by the school board's action. Because of this we condluced that the risk of liability for the employer's attorney's fees was an impermissible burden to place on one in Crisp's position. 587 P.2d at 1170, n. 7.

There are a multitude of administrative decisions, however, including the one in the case at bar, having consequences far less significant. Many of these decisions are appealable to the courts. As to these, the rule announced in Crisp does not apply. In such cases the courts may continue to assess reasonable attorney's fees against the losing party. See Rules 29(d) and 45, Alaska R. App. P.; Kodiak Western Alaska Airlines, Inc., v. Bob Harris Flying Service, Inc., 592 P.2d 1200, 1204-05 (Alaska 1979).

Since we are unable to say that the superior court's award of attorney's fees in this case amounted to an abuse of discretion, we uphold the award.[24]

The judgment of the superior court is AFFIRMED.

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24. Sjong also argues that because this appeal involves a question of genuine public interest brought in good faith, it would constitute an abuse of discretion to award attorney's fees against a losing party. Gilbert v. State, 526 P.2d 1131, 1136 (Alaska 1974). A tax dispute which primarily concerns the taxpayer's own tax liability is not the type of public interest suit contemplated in Gilbert. Such is the case here.

Appendix E

IN THE SUPERIOR COURT FOR THE
STATE OF ALASKA

FIRST JUDICIAL DISTRICT AT JUNEAU

JOHN K. SJONG,	)	
	)	
Appellant,	)	
	)	
	)	
vs.	)	
	)	
STATE OF ALASKA,	)	
DEPARTMENT OF REVENUE,	)	
	)	
Appellee.	)	
	)	File: 77-66 Civil

REPORTER'S TRANSCRIPT OF RECORD

BEFORE THE HONORABLE THOMAS B. STEWART
Presiding Superior Court Judge

Juneau, Alaska
16 August 1978
11:30 o'clock A.M.

P-R-O-C-E-E-D-I-N-G-S

BE IT REMBERED, that on the 16th day of August, 1978, at Juneau, Alaska, the foregoing matter came on for decision before the Honorable Thomas B. Stewart, Presiding Judge of the Superior Court, State of Alaska, First Judicial District at Juneau.

WHEREUPON, the following proceedings were had:

THE COURT: The matter before the Court at this time is John K. Sjong, appellant, vs. State of Alaska, Department of Revenue, appellee, Civil Action Number 77-66. This is an appeal from an administrative decision from the Department of Revenue, State of Alaska, assessing income taxes against Mr. Sjong, the taxpayer, who is a commercial crab fisherman, resident in the State of Washington. The appeal has been considered on the briefs submitted by the parties and oral argument which was held on February 14, 1978. The matter is called up at this time for statement of the Court's decision on this appeal. The decision has been substantially delayed due to the pendency of older matters and in addition, the matter presents a somewhat complex circumstance which may have some rather far-reaching effects on the non-resident crab fishermen who take king crab in international waters off-shore from the coast of Alaska and deliver their crab to Alaskan ports for further processing. The record may reflect that the matter is before the Court at this time without the presence of counsel solely for the purpose of stating a decision. It is not my purpose, at this time, to state the decision in great detail, for the reason that the matter has been long enough delayed and the decision that I am about to indicate should be sufficient for purposes of appeal to the Supreme Court in understanding the reasons why this Court reached the decision that it has.

A brief statement of background may be helpful to put the decision in context. During the years 1970, 1971 and 1972, the taxpayer owned and operated a vessel in the king crab fishery between five and one hundred fifty miles off the coast of Alaska. Seattle is designated as the vessel's home-port and the

vessel is harboured there during the off-season for repairs and otherwise. A personal property tax is paid on the vessel to the State of Washington.

Before the fisherman departs Seattle for the fishing area, he negotiates a market and a range of prices for his catch with processors who are domiciled in the State of Washington. Their offices are located there. The taxpayer hires his crew members in Washington and takes on his major provisions in that State. During the season the taxpayer enters various Alaskan ports every five to fifteen days to sell and deliver his crab to processing plants that are located in Alaska. The title and risk of loss of the crab passes upon transfer of the possession of the crab to the processor at the dock. All of the taxpayer's catch of crab is actually sold in Alaska with payment being made in the State of Washington. While in Alaskan ports, the taxpayer may obtain additional supplies such as groceries and fresh water. He may also enter Alaskan ports for other reasons such as to hire additional crew occasionally, to have emergency repairs done on the vessel's radio equipment, to obtain medical attention and to seek shelter from storms. The taxpayer also purchases bait from processors in Alaska, but he tries to stay in port only a short time in order to return to the fishing grounds as quickly as possible.

While in this case the taxpayer did not file Alaska income tax returns for the indicated years of 1970, 1971 and 1972, the returns for those years were made by the Department of Revenue and his liability was assessed at a total of some thirty-two thousand four hundred eighty-one dollars and eighty-nine cents. After the assessment was made the taxpayer requested a hearing and the hearing officer rejected the taxpayer's objections to the Alaska's jurisdiction to impose the tax and otherwise ruled that he was subject to the tax in accordance with a certain allocation of his net income to the State of Alaska. The appeal was made pursuant to AS 43.22.240 and the tax determination was made in accordance with Title 43, Chapter 20 of the Alaska Statutes, which were in effect during the time in question. There have been subsequent changes in the law but this case was considered

as the law existed at the time of the hearing officer's determination. The numerous statutes and constitutional provisions involved have been set out in both briefs and do not require repeating here. The issues presented appear to be as follows: (1) whether the taxpayer's activities within Alaska constitute sufficient connection with Alaska to satisfy the due process clause of the Fourteenth Amendment and give the State jurisdiction to impose a fairly apportioned net income tax; (2) whether imposing a fairly apportioned net income tax on the taxpayer would create an unconstitutional burden upon interstate commerce in violation of the commerce clause of the United States Constitution; (3) whether Public Law 86-272, 15 U.S.C. § 381-384, operates to prohibit the State from imposing an income tax on the taxpayer in this case; (4) whether the apportionment formula adopted by the hearing officer was fair and reasonable and whether it was a reasonable interpretation of the relevant Alaska Statutes; and (5) whether the Department of Revenue's application of the apportionment formulated in the instant case was fair and reasonable.

Before addressing those issues on the merits of the appeal, it should be noted the standard of review that the Court has applied in resolving this case. The so-called "substitution of judgment" test appears to be the proper standard for judicial review of the administrative decision here in its principle parts. The issues to be resolved turn on constitutional interpretation and statutory interpretation pertaining to both Alaska and Federal income tax laws. These matters are within the scope of the Court's special competency. The knowledge and expertiese of the agency is not conclusive on the issues and the Court has therefore considered them independently of the agency's interpretation. See Union Oil Company of California vs. Department of Revenue, 560 P2d 21 (Alaska 1977) and Alaska Public Utilities Commission vs. The Municipality of Anchorage, 555 P2d 262 (Alaska 1976).

With respect to the first issue on the jurisdiction of Alaska to impose a net income tax on this taxpayer under AS 43.20, the United States Supreme Court has been concerned with the

fairness of the tax in light of the individual taxpayer's individual relationship to the State. The question is whether the taxpayer's person or activities are sufficiently related to the State to justify taxation. Due process requires some definite link, a minimum connection between the State and the person, property or transaction sought to be taxed. Miller Bros. Co. vs. Maryland, 347 U.S. 340, 98 L.Ed. 744 (1954). Accordingly, the question to be answered in this case is whether Mr. Sjong or his business activities in Alaska are sufficient to satisfy due process requirements for the imposition of a State income tax. Without going over the extensive case citations involved in this question, it will suffice to say that I have determined that the connection in this case, which was outlined in the brief statement of background, appears to me to be sufficient to afford a due process basis for the imposition of the Alaska net income tax on this taxpayer. Accordingly, I will find in favor of the State of Alaska on that issue.

The second issue relates to the application of the commerce clause of the United States Constitution and whether it bars the imposition of the tax in this case. My review of the matter indicates that the taxpayer's objections based on the commerce clause have no support in the existing case law. The test for whether a particular state exaction creates an unconstitutional burden on inter-state commerce is similar to that for the due process clause. When dealing with the commerce clause, the Supreme Court has been concerned with the question of "whether what the State is exacting is a constitutionally fair demand by the State for that aspect of the inter-state commerce to which the State bears a special relation." Central Greyhound Lines vs. Mealey, 334 U.S. 653, 92 L.Ed. 1633 (1948). Again, it is not my intention to review the extensive case law cited by the parties, but simply to indicate my conclusion that in this case the taxpayer has failed to show that there is not a sufficient connection with the State so that it would be unfair or likely to burden inter-state commerce if the tax were applied in the circumstances of this case. There's nothing to suggest that the tax is discriminatory or that it is likely to subject inter-state

commerce to the possibility of a multiple burden. The exaction in this case is not an unapportioned tax which, by its nature, would make inter-state commerce bear more than a fair share. The taxpayer has not made any showing that multiple taxation is present. In the circumstances I will determine the commerce clause question in favor of the taxpayer.

The third issue noted is whether Public Law 86-272 operates to prohibit the State from imposing the net income tax on the taxpayer in this case. This is a statute which was passed to clarify the circumstances in which the principles of the commerce clause of the Constitution would have minimum application. Basically, it provides that no State shall impose a tax – a net income tax on the income derived from within that State by any person through inter-state commerce if the only business activity within the State by or on behalf of the taxpayer or proposed taxpayer during the year was the solicitation of orders by the person or a representative for sales of tangible personal property. It is my conclusion in this case that the taxpayer solicits orders for the crab while in the State of Washington; the orders are accepted when the taxpayer sells and delivers the crab to the processors while in Alaska. Thus, the orders are not sent out of Alaska for approval or rejection and delivery of goods is from the taxpayer's stock held within Alaska at the time of sale. The taxpayer does not fall within section 381(c) of this act because he did not operate through independent contractors in Alaska. As the hearing officer noted, the taxpayer not only brings his goods into the State, but also his business premises, that is, his boat, and his employees, that is, his crew, in order to transact his business within the State. It appears that the taxpayer has done more than merely solicit orders within Alaska, and therefore, his activities are not protected by section 381 of the Act. I am not in agreement with the taxpayer's view that his actions were only lesser included phases of a solicitation, and accordingly, I find that I agree with the appellee that Public Law 86-272 has no application in this case. The taxpayer's activities go beyond the narrow exemption for solicitation of orders. The sale transaction, that is acceptance or

rejection of the offer, the transfer of possession, the transfer of risk of loss and the production of taxable income all occur entirely within Alaska. These activities of the taxpayer exceed the solicitation of orders even under a broad interpretation of solicitation. So again, I find in favor of the State on the issue of the application of Public Law 86-272.

The next issue, item four, is whether the allocation formula adopted by the hearing officer is proper. This area of the case presents some greater conceptual difficulties in my mind, but I have reached the conclusion that the hearing officer's application of the so-called "three factor formula" set out in AS 43.20.130 to determine the amount of the taxpayer's income to be allocated to Alaska was proper. I am in agreement with the hearing officer's determination that the so-called port-day formula was proper for use in this matter and I can find nothing to show that the taxpayer has met its burden of proof to indicate the method of allocation was unfair. The question is whether the method of allocation is fairly calcuated to assign to Alaska that portion of net income reasonably attributable to the business done in Alaska. In this case it appears that the hearing officer made an honest effort to formulate a method of allocation which would assign to Alaska that amount of the taxpayer's income reasonably attributable to his business transactions here. It seems all the appellant has shown is that a different formula, one eliminating the sales factor and utilizing a service-day method, would result in less of his income being assigned to Alaska. While this may be true, it does not show that the hearing officer's formula results in the taxation of extra-territorial values. I am inclined to the view that the formulas proposed by the taxpayer would not be reasonable. The taxpayer cannot deny that without his sales of crab in Alaska his income would drop drastically. To eliminate the sales factor in the apportionment formula would be very unrealistic. While the market, which this taxpayer has, may be pre-negotiated, no sale actually occurs until the fisherman actually comes into Alaska's ports with a catch of live crab and delivers

them to the purchaser. And similarly, I believe that the case analysis made by theappellee is proper and that the hearing officer has made a reasonable interpretation of the allocation statutes. The formula appears, in its application to this taxpayer's business, to have been an honest effort to apportion to Alaska that part of the net income fairly attributable to business done within Alaska. I might note in this connection that I have considered not only the cases originally cited but also the recent case of Moorman Manufacturing Company vs. Bair, citation for which that I used having been 46 LW 4703, in the issue of Law Week published June 13, 1978. This case dealt with the Supreme Court's determination that a single factor income tax formula was not a violation of the commerce clause, and while the apportionment done in this case was by a different method, I don't find anything in the Moorman case to suggest that the determination by the Department of Revenue was in error.

The final question is whether the Department of Revenue's application of the apportionment formula to the instant case was fair and reasonable. On this issue I believe that a different standard of review should be applied and the question should be whether the Department's determination had a reasonable basis, that is, I would apply the reasonable basis test rather than substitution of judgment. In this circumstance, the Department interpreted tax forms and other information. It appears to be work of a nature involving the agency's expertise and particularized knowledge, rather than questions of law based on statutory or constitutional interpretation. It does not appear to me that there was anything improper about this issue being presented, as the appeilee has suggested, to the Court at this time, but nevertheless on review, on the standard that I have noted, I do not believe that the determination made by the Department was incorrect given the information that it had, and accordingly, I will sustain the administrative decision in this aspect as well.

The Court has, today, prepared a form of Order affirming the administrative decision of the Department of Revenue,

State of Alaska in this case, and that Order may be filed and entered.

There being nothing else to come before the Court at this time, the Court will recess subject to call.

****

END OF TRANSCRIPT

****

C-E-R-T-I-F-I-C-A-T-E

STATE OF ALASKA)
) ss.
FIRST JUDICIAL DISTRICT)

I, J. ALIMADAD-SOLTANI, Transcript Secretary for the Superior Court, State of Alaska, First Judicial District at Juneau, do hereby certify:

That the foregoing pages numbered one through twelve contain a full, true and correct transcript of the Court's decision in Case Number 77-66, John K. Sjong vs. State of Alaska, Department of Revenue, as transcribed by me to the best of my knowledge and ability and from Akai tape numbered 1324, log numbers 0109 through 0475.

DATED this 5th day of September, 1978 at Juneau, Alaska.

SIGNED AND CERTIFIED TO BY:

(Mrs.) J. Alimadad-Soltani
Transcript Secretary

Appendix F

IN THE FIRST JUDICIAL DISTRICT AT JUNEAU
STATE OF ALASKA

BEFORE THE DEPARTMENT OF REVENUE	)	
STATE OF ALASKA	)	
IN THE MATTER OF JOHN K. SJONG	)	DECISION
	)	
	)	Part I of Two Parts
JURISDICTION TO TAX PART I	)	
APPORTIONMENT OF INCOME PART II	)	

On December 3, 1974 a hearing was held at Juneau by the Department of Revenue to determine:

1. Whether John K. Sjong, hereinafter referred to as taxpayer, was liable for income taxes under the Alaska Net Income Tax Act, AS 43.20, for the years 1970, 1971 and 1972; and

2. if it is determined that the taxpayer is taxable by Alaska, whether the apportionment method used by the Department results in a fair apportionment of income to the State of Alaska.

Myron W. Klein, Revenue Hearing Examiner, was appointed by Sterling Gallagher, Commissioner of the Department of Revenue, under his powers of delegation, as Hearing Officer in this matter.

The hearing was called pursuant to AS 43.20.280 at the request of the taxpayer. John K. Sjong was represented by his attorneys, Mr. Frank J. Brown and Mr. Douglas M. Fryer. Also present were Gary L. Jenkins, Deputy Director of Audit and Arne L. Bue, Revenue Field Auditor II, both with the Department of Revenue and Mr. John R. Messenger with the Attorney General's Office.

The Department of Revenue, through Myron W. Klein, Revenue Hearing Examiner, having reviewed the evidence, files and records in this case, and after due deliberation, makes the following findings and decision.

FINDINGS OF FACT

1. Taxpayer did not file Alaska income tax returns for the years 1970, 1971 and 1972.

2. The returns were made by the Department of Revenue for the years 1970, 1971, and 1972.

3. The returns made by the Department resulted in a Notice of Demand for Payment of Taxes, dated October 10, 1974, totaling $32,481.79.

4. The taxpayer is a resident of the State of Washington and harbors his boat and other fishing property in that state when not engaged in fishing activity.

5. The taxpayer pays personal property tax on the boat to Washington.

6. Prior to traveling to the fishing area the taxpayer negotiates a market and a range of prices for his catch.

7. When the fishing season commences, the taxpayer hires a crew of employees and takes on a full load of provisions in Washington.

8. Taxpayer then travels and engages in crab fishing at distances ranging from 50 to 150 miles off the coast of Alaska.

9. The taxpayer enters the waters of Alaska and docks at various ports every five to fifteen days, or more often, as is required by the exigencies of his business.

10. The taxpayer enters Alaska in order to sell and deliver fresh live crab to buyers located at various ports.

11. While in Alaska ports the taxpayer obtains additional supplies needed to continue his activities or return home.

12. Such supplies obtained in Alaska may include bait, food, water, fuel, gear, parts or medical supplies.

13. The taxpayer enters the ports of Alaska for other reasons connected to his business such as:

a. to obtain medical attention or rapid transportation for injured or sick crew members;

b. hire additional crew;

c. obtain the services of electronics specialists or other repairmen in emergency situations; and

d. when necessary, to seek shelter from a storm.

STATUTES, REGULATIONS

1. The pertinent Alaska Statutes provide:

Sec. 43.20.010. Tax on individuals, fiduciaries, and corporations. "(a) There is levied and there shall be collected and paid for each taxable year upon the net income of every resident and nonresident individual and fiduciary that is required to make a return and pay a tax under the federal income tax law a tax equal to 16 percent of the total income tax that would be payable for the same taxable year to the United States at the federal tax rates in effect on December 31, 1963, under the provisions of chapter 1 of subtitle A of the 1954

Internal Revenue Code, Public Law 591, 83rd Congress, 2nd Session, as amended, upon all income derived from sources within the state." (Emphasis added.)

Sec. 43.20.040. Income from sources in the state. "(a) Income from sources in the state, for the purposes of this chapter, includes . . . (2) income from a business, trade, or profession, and compensation for services rendered in the state . . ."

Sec. 43.05.050. Return by department upon failure to make return or making false or fraudulent return. "If a person fails to file a return at the time prescribed by law or by regulation, . . ., the department shall make the return from the information it obtains. A return made by the department is prima facie good and sufficient for all legal purposes."

2. Public Law 86-272, Section 381 of USCA, Title 15, known as the Interstate Sales Law, defines a minimum standard of contact between a taxpayer and a state under which the jurisdiction to tax does not apply. Section 101 of P.L. 86-272 reads:

Sec. 101. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to –

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) For purposes of this section –

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

CONCLUSIONS OF LAW – PART I

The taxpayer has argued that the State of Alaska is prohibited from imposing an income tax on him since there is insufficient nexus so as to constitute a deprivation of property without due process of law in violation of the Fourteenth Amendment to the United States Constitution and because his contact with Alaska is of such a character as to exempt him from a state income tax under the Interstate Income Law, 15 USC § 381-384, also referred to herein as P.L. 86-272.

The taxpayer admits that he has certain contacts with the state but argues that these are of a minimal character such that his connection with the state is not sufficient to permit the imposition of an income tax and that a tax so imposed is a denial the due process of law. The question of the required minimum contact has been answered in several comparable cases. In Wisconsin vs J.C. Penney Co., 311 U.S. 435, 444 (1940), the court stated "the controlling question is whether the state has given anything for which it can ask return" and whether by "the practical operation of [the] tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred." The same question was posed in Northwestern States Portland Cement Co. vs State of Minnesota and in Williams vs Stockham Valves & Fittings, Inc., 358 U.S. 450, 795 Ct. 357, 3L Ed. 2d 421 (1959), where the court stated "the test was whether the taxpayer was sufficiently involved in local events to forge some definite link, some minimal connection sufficient to satisfy the due process requirements."

The taxpayer's position is that all of his net income is generated outside Alaska, except for the act of delivery of his

catch. However, the taxpayer did admit to many other kinds of contacts with the State beyond that of delivery. To answer the question of whether the act of delivery by itself or taken together with all his other contacts with the state constitute a sufficient local incidence of business activity to avoid a denial of due process, we begin with an examination of those incidents in the cases cited above.

In Northwestern States, supra, the taxpayer maintained instate a leased sales office equipped with his own furniture and fixtures and employed several persons whose function was to solicit orders for product, each order being subject to acceptance, filling and delivery from a point in another state. In Stockham Valves, supra, the taxpayer employed independent contractors instate who carried a local inventory of his product, maintained a sales office instate and used his own office equipment, supplies, and advertising literature in the state. In both cases the taxpayers argued that the state income taxes were violative of the due process of law clause of the U.S. Constitution. Justice Harlan, concurring with the court in both of the above cases, said that the taxpayers were sufficiently involved in local events to forge some definite link, some minimum connection sufficient to justify the states in the "seeking of some compensation for facilities and benefits afforded by the taxing states to income-producing activities therein, whether those activities be altogether local or in furtherance of interstate commerce."

Reference was made to these cases and the question was again decided in State of Alaska vs Petronia, 418 P. 2d 755, where the taxpayer seamen were afforded protection and benefits by Alaska when they were in port, where among other things the business activity generated by Alaska accounted for the wages they earned. The court was satisfied that the benefit of "the wages they contemplated receiving for their services during the course of the vessel's voyage" was sufficiently connected to and afforded by the economic activity of the State of Alaska to constitute a minimum connection.

In this situation, the State of Alaska directly contributes to the success of the taxpayer's fishing activities. The State does this by regulating fishing activities as a whole, by monitoring and restoring the quality of the waters in which the fish survive and propagate, and by regulating other business activities which have the potential for destroying the whole fishing industry without such state protections. The State also maintains a vigilance over the fish catches so as to advise fishermen and processors regarding the prospects of a coming season. Alaska also provides certain services such as marine facilities which make it easier to operate a ready market for the taxpayer's catch. The taxpayer takes advantage of benefits available from the State of Alaska to seamen and fishermen such as the availability of bait, food, water, fuel, gear, parts and medical supplies. Other benefits afforded the taxpayer come in the form of calm ports to unload and transfer the catch, labor markets, emergency repair services, safe harbors in stormy weather and a market in which the catch may be sold. Without access to markets in Alaska the taxpayer's fishing activities would be less profitable since the quality of his catch when finally brought to market would be lower and his time available for fishing would be less. Without these opportunities, protections, and benefits provided by Alaska, the taxpayer's chances for success would be greatly diminished. Hence we find this taxpayer engaging in a greater number of local incidents of business activity that are both sufficient and necessary for the continuance and success of his activity, than were present in State of Alaska vs Petronia. As a minimum the taxpayer contemplated receiving income for his fishing efforts from the business productivity generated by Alaska. And, as a minimum, the productivity generated by Alaska was accountable for the income earned by the taxpayer.

Beyond the minimum connection observed in Alaska vs Petronia, supra, (the benefit of employment afforded by Alaska economic activity) here the taxpayer also looked to Alaska for other protections such as the services and resupply items he acquired in Alaska. The state is justified in seeking some

compensation for the benefits it has afforded. A sufficient connection exists in the generation of income from fishing, as indeed the process of fishing results in no profits until it ends in sales. Nor would the process of fishing proceed to a successful end without the other protections and benefits afforded fishermen by Alaska. The many benefits afforded the taxpayer in pursuing the success of his business form a sufficient nexus between the taxpayer's business activities and the State of Alaska to avoid denial of due process of law. And, a tax, laid on the income derived within Alaska as a result of the success of the taxpayer's fishing activity, does bear a special relation to the protections and benefits conferred by the state and is, therefore proper.

The taxpayer contends that P. L. 86-272, which defines certain circumstances where the nexus between a taxpayer and a state is not sufficient for the state to impose an income tax, applies to his situation. The business activities specifically referred to in P. L. 86-272 as being allowed to proceed within a state without income tax consequences ("if [they are] the only business activities") are the solicitation of customers and the solicitation of customer's customers, if, in either case, the resulting sale made by the soliciting taxpayer is interstate in character. The permissible activities are in two parts. The first part, contained in Subsection 101(a), deals with direct activities by a taxpayer and his representative and the second part, contained in subsection 101(c), deals with indirect activities conducted not by the taxpayer or his representative but by independent contractors. The language of the law in subsection 101(a) makes it clear that the taxing prohibition applies "if the only business activity within such state by . . . such person during such taxable year is the solicitation of orders by such person, or his representative, in such state for sales of tangible personal property; which orders are sent outside the state for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the state . . . " What is normally known as a sales activity is described by the law as three distinct

business activities: (1) solicitation of orders; (2) approval or rejection of orders; and (3) fullfillment of orders by delivery. The exemption from taxation circumstance applies only when the solicitation for the order happens within the state whereas the approval and delivery of the order must originate from without the state such that an interstate character persists as to the latter two activities.

P. L. 86-272 prohibits the imposition of an income tax on a solicitor who merely secures orders for himself or some other person. If the solicitor carries his stock of goods with him and sells from this stock, he is no longer a solicitor, and his interstate character ceases because he is making sales from a stock of goods located within the taxing state. Only when a solicitor does not carry a stock of goods for sale, and only when the orders he takes are sent outside the state for acceptance or rejection and filled by interstate shipment will his interstate character persist under P. L. 86-272.

The taxpayer said his "only function in Alaska was to unload and deliver the catch". In so doing the taxpayer is not "a solicitor of orders" to buy his crab. He is, in fact, selling and delivering tangible personal property, in accordance with a previously solicited agreement in the State of Washington. Further, each sale order of crab, secured at dockside, is not sent outside Alaska for approval or rejection. Since the crab is in Alaska before it is offered for sale the taxpayer is in fact selling from a stock of goods within Alaska wherein the sale is completed by delivery from the taxpayer's boat at dockside to the processor on the dock. There is no interstate character to either of the two activities (approval and subsequent delivery) that are required to be interstate in character in Subsection 101(a), P. L. 86-272. The owner must ship the goods after approval of a purchase order from a point without the State to qualify for the exemption. In the taxpayers situation the goods are already within Alaska.

The taxpayer has also argued that subsection 101(c) covers sales of tangible personal property within the State. This only applies when the sale is made "on behalf of such person [taxpayer] by one or more independent contractors." The taxpayer not only brings his goods into the State for sale but also brings his total business premises, together with his employees. Even so much as a stock of goods or a sales office in the state forfeits the benefits of P. L. 86-272. Because the taxpayer's contacts with Alaska are not limited to the instate employment of independent contractors, subsection 101(c) does not apply.

The taxpayer takes the position that the exemption of P.L. 86-272 applies because he is engaged in a lesser phase of "the specifically described phase of interstate sales efforts." The case cited is Smith Kline and French Laboratories vs State Tax Commission, 403 P. 2d 375, at Page 377, where the taxpayer employed "detail men" to explain his products to prospective purchasers. There the taxpayer was exempt from a tax on net income because the taxpayer's representative was engaged in a lesser phase of solicitation. Everything that constitutes the solicitation phase of sales qualifies. But anything that goes beyond the solicitation phase does not. Note that the court said the Interstate Income Law" exempted only the specifically described phase of [the] interstate sales effort [including] all lesser . . . phases [of the described phase]." The "described phase of interstate sales" that they made reference to is the solicitation phase. No additional phase such as approval, filling or delivery is included. The court's conclusion is consistent with this view. They correctly concluded that when a drummer ("detail man") explains a product to a prospective purchaser the taxpayer employing the drummer is engaged in a lesser phase of solicitation. Here the taxpayer argues that "the importance of the holding in Smith Kline, supra, case is that the Interstate Income Law is not to be construed so narrowly as to be applied only in situations where there is an actual solicitation of an order followed up by shipment or delivery from a point outside the State." But the holding in Smith Kline, supra, does

not agree with the taxpayer's interpretation of the case. The court is saying that the Interstate Income Law is not to be construed so narrowly as to apply to situations where the whole solicitation phase is present but also to situations where only a lesser phase of the solicitation phase is present. The Congressional Committee reports which led to the enactment of the Interstate Income Law show that Congress intended to exempt solicitation and lesser phases of solicitation.

The taxpayer admits that "in Smith Kline [supra] . . . activities which did not amount to the solicitation of an order would not qualify the taxpayer for exemption." The sales activities of acceptance, filling, and delivery of Mr. Sjong occurring within Alaska do not amount to solicitation to which the law applies but rather are additional phases of the sales effort. The taxpayer argues that such a broadening of the Interstate Income Law was within the meaning of the Smith Kline holding. Congressman Miller of New York disagreed when he said that

> ". . . this legislation is not broad in its effect. It is very narrow, indeed. It covers only the single and simple area where a corporation does nothing more within a state than solicit orders. If that is all the corporation does within the taxing state, simply soliciting orders, then under this bill they are exempt from multiple taxation. . ." (Emphasis added) (Quoted from Prentice-Hall, State and Local Taxes, All States Unit appearing on page 91,222)

Here the taxpayer not only engages in other broader phases of the sales process but also other non-sales activities that are a necessary and integral part of his fishing activity.

The taxpayer also relies on the decision in Martinac v County of San Diego, 255 Cal. App. 2d 175, 63 Cal. Rep. 64 (1967), where the court decided that the taxing jurisdiction could not impose an ad valorem personal property tax on a fishing vessel in the San Diego port delivering its catch, obtaining

provisions and repairs and returning to the high seas. Though the factual pattern is very close to this case, the type of tax, the principals of its imposition and the sufficiency of nexus required to impose the tax are different from a tax imposed on net income. The principles of imposition of each tax are closely related to the protections, opportunities and benefits a taxing jurisdiction confers on the person in respect of the tax. When property is located in a jurisdiction the owner benefits from the laws conferring the right of ownership, use and enjoyment. The relative constancy of these benefits is matched by the imposition of a tax, with less impunity than the tax on income, on a person for possession of property. There the nexus between taxpayer and taxing jurisdiction has a possessive character. The income tax, however, is an activity related tax wherein the taxing jurisdiction confers opportunities, benefits and protections to the taxpayer to encourage his success in his business activities. The variable result of these activities is accompanied by a variable tax burden. Here the nexus between taxpayer and taxing jurisdiction is predicted on fishing activities within or nurtured by the State of Alaska. It should be noted that the State is not presently imposing a property tax on the taxpayer's property, which is consistent with the Martinac case.

The ad valorem personal property tax is also discussed in State of Alaska vs Petronia, supra, where the court said that the Alaska Net Income "tax is not a direct tax upon interstate commerce or the vessels engaged therein. It is rather a tax upon the income derived therefrom, properly apportioned so as to tax only that net income of seamen which is earned within the jurisdiction of Alaska."

DECISION – PART 1

It is well to remember that the taxpayer has shown he has other activities in Alaska that go beyond the scope of P. L. 86-272. He has suggested that the time involved or the direct cost of these activities in Alaska is not a sufficient nexus because he,

like other fishermen, could just as well do without these activities within the State. He concludes they bear a minor relation to his total activity and are therefore insufficient for nexus to apply.

It is difficult to believe that these essential contacts with Alaska do not afford the petitioner the opportunities, protections, and benefits Alaska provides the fishing industry. These contacts sufficiently benefit the taxpayer such that without them he would not achieve nearly the degree of success that he has enjoyed so far. To accept the taxpayer's premises of insufficiency would work a special disadvantage to local fishermen engaging in precisely the same activities in precisely the same places. The benefits provided by Alaska in the futherance of these fishing activities are equally enjoyed by local and nonresident fishermen. The taxpayer not only engages in nonexempt phases of the sales process but also other nonsales activities that are a necessary and integral part of his fishing activity in Alaska. The benefits of sales, facilitative services and employment, afforded by this economic activity of the State of Alaska constitute minimum connection within the rule to avoid a denial of due process of law and to permit the imposition of the net income tax. Therefore, in accordance with AS 43.20.010 and 43.20.040, John K. Sjong is taxable on all income derived from his business and trade within Alaska.

PART II

The Department may make a return from information it obtains and "a return so made is prima facie good and sufficient for all legal purposes" (AS 43.05.050). However, since the taxpayer has indicated an interest in filing the required returns, the second part of this decision will be withheld for 90 days from the date of the decision to Part I.

The taxpayer is to file or cause to file returns for himself, the corporations he owns and the partnerships (joint ventures, etc.) in which he or the corporations are partners, within 30 days from the date of the decision to Part I. The income of each taxpayer should be determined using a combined report (apportionment of the unitary group income).

Myron W. Klein
Revenue Hearing Examiner

July 1, 1975 Date

CERTIFICATION OF DELEGATION OF AUTHORITY

I, Sterling Gallagher, Commissioner of Revenue, pursuant to the provisions of AS 44.25.020, have delegated to Myron W. Klein, Revenue Hearing Examiner, all powers vested in the Department of Revenue, to hold a hearing with the taxpayer, John Sjong, and to deliberate upon the evidence produced at the hearing and to make a final administrative determination in this matter for the Department of Revenue. I certify that the attached decision is the final administrative determination for Part I of two parts of the Department of Revenue in this matter.

DATED at Juneau, Alaska this 2 day of July, 1975.

Sterling Gallagher
Commissioner of Revenue

APPROVED AS TO FORM:

John R. Messenger
Assistant Attorney General

Appendix G

IN THE FIRST JUDICIAL DISTRICT AT JUNEAU
STATE OF ALASKA

BEFORE THE DEPARTMENT OF REVENUE	)	
STATE OF ALASKA	)	
IN THE MATTER OF JOHN K. SJONG	)	DECISION
	)	
	)	Part II of Two Parts
JURISDICTION TO TAX PART I	)	
APPORTIONMENT OF INCOME PART II	)	

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1. Whether John K. Sjong, hereinafter referred to as taxpayer, was liable for income taxes under the Alaska Net Income Tax Act, AS 43.20, for the years 1970, 1971, and 1972.

2. If it is determined that the taxpayer is taxable by Alaska, whether the apportionment method used by the Department results in a fair apportionment of income to the State of Alaska.

Myron W. Klein, Revenue Hearing Examiner, was appointed by Sterling Gallagher, Commissioner of the Department of Revenue, under his powers of delegation, as Hearing Officer in this matter.

The hearing was called pursuant to AS 43.20.280 at the request of the taxpayer. John K. Sjong was represented by his attorneys, Mr. Frank J. Brown and Mr. Douglas M. Fryer. Also present were Gary L. Jenkins, Deputy Director of Audit, at that time, and Arne L. Bue, Revenue Field Auditor II, both with the Department of Revenue, and Mr. John R. Messenger with the Attorney General's Office.

The Department of Revenue, through Myron W. Klein,

Revenue Hearing Examiner, having reviewed the evidence, files, and records in this case, and after due deliberation, makes the following findings and decisions.

FINDINGS OF FACT

1. Taxpayer did not file Alaska income tax returns for the years 1970, 1971, and 1972.

2. The returns were made by the Department of Revenue for the years 1970, 1971, and 1972.

3. The returns made by the Department resulted in a Notice of Demand for Payment of Taxes, dated October 10, 1974, totaling $32,481.79.

4. The taxpayer is a resident of the State of Washington and harbors his boat and other fishing property in that State when not engaged in fishing activity.

5. The taxpayer pays personal property tax on the boat to Washington.

6. Prior to traveling to the fishing area, the taxpayer negotiates a market and a range of prices for his catch.

7. When the fishing season commences, the taxpayer hires a crew of employees and takes on a full load of provisions in Washington.

8. Taxpayer then travels and engages in crab fishing at distances ranging from 50 to 150 miles off the coast of Alaska.

9. The taxpayer enters the waters of Alaska and docks at various ports every five to fifteen days, or more often, as is required by the exigencies of his business.

10. The taxpayer enters Alaska in order to sell and deliver fresh live crab to buyers located in various ports.

11. While in Alaska ports, the taxpayer obtains additional supplies needed to continue his activities or return home.

12. Such supplies obtained in Alaska may include bait, food, water, fuel, gear, parts, or medical supplies.

13. The taxpayer enters the ports of Alaska for other reasons connected to his business such as:

a. To obtain medical attention or rapid transportation for injured or sick crew members.

b. Hire additional crew.

c. Obtain the services of electronic specialists or other repairmen in emergency situations.

d. When necessary, to seek shelter from a storm.

14. Part I to this Decision contained the requirement that the taxpayer file returns for himself, the corporations he owns, and the partnerships (joint ventures, etc.) in which he or the corporations are partners by August 1, 1975. As of the date of this Decision, the 1972 Individual Return has not been received in connection with this request.

STATUTES, REGULATIONS

Pertinent parts of the Alaska statute provide:

Section 43.20.010. Tax on individuals, fiduciaries, and corporations.

(a) There is levied and there shall be collected and paid

for each taxable year upon the net income of every resident and nonresident individual and fiduciary that is required to make a return and pay a tax under the federal income tax law a tax equal to 16 percent of the total income tax that would be payable for the same taxable year to the United States at the federal tax rates, in effect, on December 31, 1976, under the provisions of Chapter 1 of Subtitle A of the 1954 Internal Revenue Code, Public Law 591, 83rd Congress, 2nd Session, as amended, upon all income derived from sources, within the State.

Section 43.20.040. Income from sources in the State.

(a) Income from sources in the State, for the purposes of this Chapter, includes . . . (2) income from a business, trade, or profession, and compensation for services rendered in the State . . .

Section 43.20.050. Taxpayers liable.

(a) A taxpayer who has income from business activity which is taxable both inside and outside this State or income from other sources both inside and outside this State shall allocate and apportion his net income as provided in §§ 50-150 of this Chapter.

Section 43.20.130

(e) Sales of tangible personal property are in this State if:

(1) the property is delivered or shipped to a purchaser, other than the United States government, inside this State regardless of the f.o.b. point or other conditions of the sale . . .

(g) The value of vessels operating on the high seas and

compensation of employees engaged in operating the vessels shall be apportioned to the State in the ratio which the number of days spent in ports inside the State bears to the total number of days spent in ports inside and outside the State. The term "days spent in ports" does not include periods when ships are tied up because of strikes, or withheld from the Alaska service for repairs, or because or seasonal reduction of service. Days in port are computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to, and inside the State and compensation of employees so engaged are apportioned to the State in the ratio which the number of days during which services are rendered inside the State bears to the total number of days during which the services are rendered inside and outside the State.

CONCLUSIONS OF LAW – PART II

In determining the amount of income taxable by Alaska, the Audit Division adhered to its position in Alaska Revenue Ruling 74-2 which states in part that "if all fish products are taken in international water and sold in Alaska only, apportionment shall not apply and all income from fishing is to be reported to Alaska". Since no returns had been filed by the taxpayer, the Audit Division acted under the authority of AS 43.05.050 and AS 43.20.160(a) to make a return from information it had obtained, and prepared returns applying the above quoted Revenue Rule. The question presented in this part is whether the assignment of all income to Alaska is fair, and if not, what method of apportionment should be applied to the taxpayer's circumstances.

The taxpayer emphasizes in his supplemental brief of October 3, 1975, that the Findings of Fact in Part I "establish most of the essential facts in this proceeding, [h]owever, they do not emphasize that the majority of shoreside business

management is performed by the taxpayer in the State of Washington and all the fishing activity occurs outside the State of Alaska." In the taxpayer's view, these facts are best represented by a formula which takes into account: A property factor for the use of property within Alaska verses the total time in the tax period; a payroll factor for the employment of crew within Alaska verses the total time the crew is in the service of the vessel; and nothing (no sales factor) in respect of the realization of gross income from the sales of the catch.

The taxpayer also relies on the principal described in Internal Revenue Service Revenue Ruling 75-483 that income earned by a vessel while it is not within United States territorial waters is not treated as income from sources within the United States. The Alaska Net Income Tax Act incorporates the Internal Revenue Code, including Subchapter N, Chapter 1, of Subtitle A, which in general concerns "taxes based on income from sources within or without the United States", except those provisions which are modified by or are manifestly inapplicable with the intent of AS 43.20. Revenue Ruling 75-483 concerns source of income concepts in IRC §§ 861 through 864 in Subchapter N. Unlike the Internal Revenue Code, the Alaska net income tax, as it applies to nonresidents, is not based on income both from sources within or without the United States. The Alaska tax is based on income from sources within Alaska. Accordingly, the application of Subchapter N within State law is more limited.

Definitions in state law concerning the source of income supersede those contained in Subchapter N, wherever the IRC definitions are inconsistent with State law. Federally the purpose of Part I under Subchapter N (upon which Revenue Ruling 75-483 is based) is not to define the jurisdictional limitation on the reach of the federal income tax but rather to specify the source of the income for purposes of determining the amount of foreign income tax credit which may be allowable against the United States tax. Federally the Internal Revenue Code

reaches the bare boat charter income described in Revenue Ruling 75-483, regardless of whether it is from sources within or without the United States provided the taxpayer is a United States citizen or a domestic corporation. Under the Alaska tax, those provisions are superseded by AS 43.20.010 and AS 43.20.040 which limit the reach of the Alaska tax to income from sources within Alaska and specify that income from sources in this State includes income from a trade or business in the State. Accordingly, the source of income derived from bare boat charter is determined under AS 43.20.040.

The decision to this case in Part I was that the taxpayer's fishing activities benefited from such local activities as sales, facilitative services and employment as to constitute the minimum connection sufficient to allow the imposition of an income tax on the income from the trade or business of fishing. Here all of the taxpayer's gross income from crab fishing is realized from instate sales. Such income is from sources within Alaska and would be fully taxable. However, where the taxpayer's income from the activity may be taxed by another state, AS 43.20.050 provides that the income which is taxable both inside and outside this State shall be allocated and apportioned as provided in §§ 50-150 of Chapter 20.

While the Audit Division has placed some reliance on the authority in AS 43.20.140(a)(3) "for the Commissioner to require the employment of another method to determine an equitable allocation and apportionment of the taxpayer's income", this is not necessary since the provisions of AS 43.20.130 when properly and carefully interpreted provide an adequate and fair application of apportionment to the taxpayer's circumstances.

Thus, AS 43.20.040(a)(2) provides that income from a business conducted in the State is income derived from sources in Alaska; AS 43.20.050 provides that when the business income as is derived from sources within this State shall be

determined by apportionment; and AS 43.20.130 defines the income derived from sources within Alaska as that determined by application of the three (3) factor formula. To the extent any one of the three (3) factors (instate property, payroll or sales values) assign income to Alaska that would not be assigned by a source definition in the Internal Revenue Code, those provisions in State statute supersede the inconsistent portions of the IRC.

We do not think that the taxpayer's alternative two (2) factor method or the Audit Division's full assignment method are appropriate. Both apportionment proposals tend to the extreme. The Audit Division's proposal, in the sense that the taxpayer is made taxable on his entire income becuase the income was fully realized within Alaska; and the taxpayer's, in the sense that the only income assigned to Alaska, was in respect of property and employees which had entered the State in the course of their business without giving value to the realization of income or the activities whose value can only be realized through the sale.

The apportionment provisions of AS 43.20.130 are applicable if a taxpayer has business income from a business activity which is taxable both inside and outside this State. The position taken by the Audit Division in assigning the full amount of income to Alaska is based on the assumption that the income from the taxpayer's activities are not taxable elsewhere. The evidence shows that certain aspects of the taxpayer's fishing business (such as managing the affairs of Olympic Fisheries, Inc. negotiating a market for the sale of the crab and negotiating the charter of the vessel to others) are conducted wholly within Washington State on a level sufficient to allow that state to tax a portion of the income derived from fishing or chartering activities. Accordingly, we believe apportionment is applicable here as provided in AS 43.20.050 through AS 43.20.150. The Alaska apportionment factors should be determined as follows.

Sales Factor

AS 43.20.130(e)(1) provides that "sales of tangible personal property are in this State if the property is delivered or shipped to a purchaser . . . inside this State regardles s of the f.o.b. point or other conditions of the sales . . ." The crab are tangible personal property delivered to a purchaser within Alaska and regardless of the other conditions of the sale (for instance, a market negotiated outside the State) are assignable to Alaska for purposes of the sale factor.

Property and Payroll Factor

The first sentence of AS 43.20.130(g) provides that "the value of vessels operating on the high seas and compensation of employees engaged in operating the vessels shall be apportioned to the State in the ratio which the number of days spent in ports inside the State bears to the total number of days spent in ports inside and outside the State". The taxpayer states in his brief dated October 3, 1975, that "there is a further section in AS 43.20.130(g) which is obviously intended to apply to the Alaska steamship type service and not to fishing on the high seas". From this argument, the taxpayer concludes that a port day formula was meant to be applied to freighters and that fishing vessel property and payroll factors should be measured by the number of days during which services are rendered in Alaska. However, a careful reading of AS 43.20.130 leads to a different conclusion.

The provision which states that the property and payroll values should be determined by reference to the "number of days during which services are rendered inside the state [in relation] to the total number of days during which the services are rendered inside and outside the State", occurs in the fourth sentence in that Subsection. That sentence refers only to "aircraft and automotive vehicles operating as freight and passenger carriers". A fishing vessel does not come within the description

of "an aircraft or automotive vehicle". Accordingly, a fishing vessel has been explicitly excluded from those types of property which may use the "days of service" standard sought by the taxpayer in his brief.

The correct standard provided by statute is found in the first sentence in that Subsection quoted above. There the phrase "vessels operating on the high seas" clearly may include fishing vessels operating on the high seas. Accordingly, the property value of a fishing vessel and the payroll value of compensation of the crew engaged in operating the vessel should be determined by the port day method, provided for in that sentence.

The second sentence of AS 43.20.130(g) provides that "the term 'days spent in port' does not include periods when ships are tied up because of strikes, or withheld from the Alaska service for repairs, or because of seasonal reduction of service..' For purposes of a fishing vessel, the phrase "seasonal reduction of service" includes idle time between fishing seasons or between charters. The term "days spent in port" may include time spent stocking the boat with supplies and readying it for a specific income producing activity immediately prior to departure for a fishing voyage, time spent cleaning up the vessel immediately upon its return from an income producing activity, and the time spent delivering fish and taking on additional supplies during the fishing season.

The phrase "employees engaged in operating the vessel" includes crew. Fishermen may or may not be included depending on the extent to which they perform services in operation of the vessel. To the extent services are performed in connection with land based activities, the compensation should be assigned to the geographic area where the services are performed. Land based services, which are separate and distinct from those services performed while in service of the vessel, may include off-season repair work or management services.

If a fisherman's compensation does not depend on the extent to which they perform services in operation of the vessel, and the port day method does not reasonably approximate the contribution of business activity in Alaska to the wages earned by the fisherman, the compensation of the fisherman should be assigned to Alaska in proportion to the business activity generated by Alaska in relation to the business activity generated inside and outside Alaska. This standard was suggested in State of Alaska vs. Petronia, 418 P 2d 755 (1966), where the Court observed that "the business productivity generated by Alaska was accountable for the wages earned by the defendants when they were in Alaskan waters". As we have stated where the port day method does not reasonably approximate the business generated by Alaska, another method should be employed. In particular, where the sale of fish or crab was accountable for the wages earned by a fisherman, and the principal activities consisted of fishing rather than operating the vessel, the wages should be assigned to Alaska by the portion of sales generated inside Alaska in relation to the sales generated inside and outside Alaska, taking into account only those sales which were accountable for the fisherman's wages. This method would be most appropriate where the fisherman's compensation is directly related to and contingent on the value realized from the sale of the catch.

The Alaska portion of the taxpayer's income, which is attributable to personal services, should be determined by reference to that portion of his employer's Alaska payroll factor which constitutes his compensation. The Alaska portion of the taxpayer's income, which is attributable to his ownership of a trade or business (whether in corporate, "Sub-S", partnership or proprietorship form), should be determined by application of the three (3) factor formula as discussed in the previous paragraphs. Where, as in this case, the taxpayer performs substantial services for a business in which he is a part owner, his Alaska income must be determined by taking into account both a value for his services to the business and a value of income

derived from the business, as an owner. Here the taxpayer's total income from Olympic Fisheries, Inc. would be broken down into (1) wages and (2) trade or business income. The former should be assigned to Alaska exactly as it is assigned to Alaska in the Olympic Fisheries, Inc. payroll factor and the latter should be apportioned to Alaska in accordance with the three (3) factor formula. For purposes of the payroll factor in a "Sub-S" corporation, partnership, or proprietorship trade or business, which accounts for the net business income without showing a tax deduction for a fair value of services rendered by the owner or part owner, a fair value of compensation should be determined.

The taxpayer has not submitted returns for 1972. Accordingly, the Department may base the assessment on the information relied on in the 1972 return prepared by the Department which is "prima facie good and sufficient for all legal purposes" (AS 43.05.050 and AS 43.20.160) and such other evidence submitted by the taxpayer without the verification required by IRC § 6065 as the Audit Division deems appropriate.

DECISION

1. Provisions in the Internal Revenue Code, which define the source of income different from Chapter 20, are superseded by the source of income definitions in Chapter 20.

2. The taxpayer's trade or business income attributable to Alaska business should be determined by use of the three (3) factor apportionment formula as provided for in AS 43.20.130.

3. The sales factor should be determined as required in AS 43.20.130(a)(1) and the property and payroll factors should be determined as required in AS 43.20.130(b) and (c). Where the income producing activity is attributable to the operation of a vessel on the high seas as in fishing activities, such property and the payroll of employees engaged in operating the vessels,

should be assigned to the State pursuant to the "port day" method prescribed in AS 43.20.130(g).

4. Where the compensation of a fisherman does not depend on his providing services in operation of the vessel on the high seas (fishing is substantially the only required service) and where the port day method does not reasonably approximate the value of wages accountable for by the business generated by Alaska, the payroll factor should be determined by reference to the corresponding sales of fish or crab.

5. The taxpayer's income received or earned in respect of services performed for an employer (regardless of whether the taxpayer partly owns the employer) should be attributed to Alaska by reference to his employer's payroll factor.

The Audit and Enforcement Divisions are instructed to redetermine, assess, and collect the taxes due based on the application of this decision to the evidence submitted by the taxpayer under penalties of perjury, or in the case of the 1972 return to the facts relied on by the Audit Division in their preparation of the 1972 return, or such other information for 1972 as the Audit Division deems appropriate.

DATED AT JUNEAU, ALASKA THIS 2nd DAY OF November, 1976.

Myron W. Klein, CPA
Revenue Hearing Examiner

Appendix H
Constitutional Provisions

U.S. CONSTITUTION ARTICLE I § 8

Section 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

To provide for the Punishment of counterfeiting the Securities and current Coin of the United States;

To establish Post Offices and post Roads;

To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;

To constitute Tribunals inferior to the supreme Court;

To define and punish Piracies and Felonies committed on the high Seas, and Offences against the Law of Nations;

To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water;

To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years;

To provide and maintain a Navy;

To make Rules for the Government and Regulation of the land and naval Forces;

To provide for calling forth the Militia to execute the Laws of the Union, suppress Insurrections and repel Invasions;

To provide for organizing, arming, and disciplining, the Militia, and for governing such Part of them as may be employed in the Service of the United States, reserving to the States respectively, the Appointment of the Officers, and the

Authority of training the Militia according to the discipline prescribed by Congress;

To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings; – And

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

U.S. CONSTITUTION AMENDMENT XIV § 1

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Section 2. Representatives shall be apportioned among the several States according to their respective numbers, counting the whole number of persons in each State, excluding Indians not taxed. But when the right to vote at any election for the choice of electors for President and Vice President of the United States, Representatives in Congress, the Executive and Judicial officers of a State, or the members of the Legislature thereof, is denied to any of the male inhabitants of such State, being twenty-one years of age, and citizens of the United States, or in any way abridged, except for participation in rebellion, or other crime, the basis of representation therein shall be reduced in the proportion which the number of such male citizens shall bear to the whole number of male citizens twenty-one years of age in such State.

Section 3. No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the United States, or under any State, who, having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any State legislature, or as an executive or judicial officer of any State, to support the Constitution of the United States, shall have engaged in insurrection or rebellion against the same, or given aid or comfort to the enemies thereof. But Congress may by a vote of two-thirds of each House, remove such disability.

Section 4. The validity of the public debt of the United States, authorized by law, including debts incurred for payment

of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

Section 5. The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

§ 43.19.010 (1977)

The Multistate Tax Compact is hereby enacted into law and entered into with all jurisdictions legally joining in it, in the form substantially as follows:

ARTICLE IV. DIVISION OF INCOME.

1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipe line, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or

approved by a federal, state or local government or governmental agency.

(g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

(h) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(i) "This state" means the state in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and outside this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another state if (1) in that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

4. Rents or royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state: (1) if and to the extent that the property is utilized in this state, or (2) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, gangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales of tangible personal property are allocable to this state if (1) the property had a situs in this state at the time of the sale, or (2) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

7. Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

8. (a) Patent and copyright royalties are allocable to this state: (1) if and to the extent that the patent or copyright is utilized by the payer in this state, or (2) if and to

the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the tax administrator may require the

averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this state if:

(a) the individual's service is performed entirely within the state;

(b) the individual's service is performed both inside and outside the state, but the service performed outside the state is incidental to the individual's service within the state; or

(c) some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everwhere during the tax period.

16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the state of the purchaser.

17. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state; or

(b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

§ 45.02.106(a) (1980)

(a) In AS 45.02.101 – 45.02.725, unless the context otherwise requires, "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "Sale" consists in the passing of title from the seller to the buyer for a price (AS 45.02.401). A "present sale" means a sale which is accomplished by the making of the contract.

§ 45.02.401(2) (1980)

(2) Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite a reservation of a security interest and even though a document of title is to be delivered at a different time or place; in particular and despite a reservation of a security interest by the bill of lading.

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(B) if the contract requires delivery at destination, title passes on tender there.

Ch. 115, § 5(A)(2)(b), 1949 Alaska Sess. Laws

Section 5. TAX ON INDIVIDUALS, FIDUCIARIES, CORPORATIONS AND BANKS.

A. GENERAL RULE. There is hereby levied and there shall be collected and paid for each taxable year upon the net income of every individual (except employees whose sole income in Alaska consists of wages or salary upon which tax has been withheld as referred to in subsection B of this Section), fiduciary, corporation and bank, required to make a return and pay a tax under the Federal income tax law, a tax computed by either one of the following methods:

(1) a tax equal to 10 percent of the total income tax that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code without the benefit of the deduction of the tax payable hereunder to the Territory.

(2) a tax equal to 10 percent of that portion of the total income tax that would be payable under the provisions of the Internal Revenue Code without the benefit of the deduction of tax payable hereunder to the Territory, that

gross receipts derived from sources within the Territory, payroll and value of tangible property located in the Territory, bears to the total gross receipts from sources within and without the Territory, payroll and value of tangible property within and without the Territory.

(a) DETERMINATION OF GROSS RECEIPTS. Gross receipts from sources within the Territory shall consist of interest, rents, royalties, gains, dividends, all other income and gross income received or derived in connection with property owned or a business or trade carried on and salaries, wages and fees for personal services performed within the Territory. Income received or derived from sales wherever made of goods, wares and merchandise manufactured or orginating in the Territory shall be considered to be a part of gross receipts from sources within the Territory.

(b) DETERMINATION OF PROPERTY AND PAYROLL FACTORS FOR FREIGHT AND PASSENGER CARRIERS. The value of vessels operating on the high seas and compensation of employees engaged in operating such vessels shall be apportioned to the Territory in the ratio which the number of days spent in ports within the Territory bears to the total number of days spent in ports within and without the Territory. The term "days spent in ports" shall not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or because of seasonal reduction of service. Days in port shall be computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to and within the Territory and compensation of employees engaged in such operations, shall be apportioned to the Territory in the ratio which the number of days during which such services are rendered within the Territory bears to the total number of days during which such services are rendered within and without the Territory.

Ch. 132, § 5(D), 1951 Alaska Sess. Laws

D. DETERMINATION OF PROPERTY AND PAYROLL FACTORS FOR FREIGHT AND PASSENGER CARRIERS. The value of vessels operating on the high seas and compensation of employees engaged in operating such vessels shall be apportioned to the Territory in the ratio which the number of days spent in ports within the Territory bears to the total number of days spent in ports within and without the Territory. The term "days spent in ports" shall not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or because of seasonal reduction of service. Days in port shall be computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to and within the Territory and compensation of employees engaged in such operations, shall be apportioned to the Territory in the ratio which the number of days during which such services are rendered within the Territory bears to the total number of days during which such services are rendered within and without the Territory.

Ch. 175, § 5(c)(20), 1959 Alaska Sess. Laws

(20) Determination of property and payroll factors for freight and passenger carriers. The value of vessels operating on the high seas and compensation of employees engaged in operating such vessels shall be apportioned to the state in the ratio which the number of days spent in ports within the state bears to the total number of days spent in ports within and without the state. The term "days spent in ports" shall not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or because of seasonal reduction of service. Days in port shall be computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive

vehicles operating as freight and passenger carriers from, to and within the state and compensation of employees engaged in such operations, shall be apportioned to the state in the ratio which the number of days during which such services are rendered with the state bears to the total number of days during which such services are rendered within and without the state.

§ 43.20.130 (repealed 1975)

(a) All business income which cannot be directly apportioned and allocated to this state shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

(b) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less the annual rental rate received by the taxpayer from subrentals. The average value of property is determined by averaging the values at the beginning and ending of the tax period but the commissioner of revenue may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(c) The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period. Compensation is paid in this state if

(1) the individual's service is performed entirely inside the state;

(2) the individual's service is performed both inside and outside the state, but the service performed outside the state is incidental to the individual's service inside the state; or

(3) some of the service is performed in the state and (A) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (B) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(d) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

(e) Sales of tangible personal property are in this state if

(1) the property is delivered or shipped to a purchaser, other than the United States government, inside this state regardless of the f.o.b. point or other conditions of the sale; or

(2) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (A) the purchaser is the United States government, or (B) the taxpayer is not taxable in the state of the purchaser.

(f) Sales, other than sales of tangible personal property, are in this state if

(1) the income-producing activity is performed in this state; or

(2) the income-producing activity is performed both inside and outside this state and more of the income-producing activity is performed in this state than in any other state, based on costs of performance.

(g) The value of vessels operating on the high seas and compensation of employees engaged in operating the vessels

shall be apportioned to the state in the ratio which the number of days spent in ports inside the state bears to the total number of days spent in ports inside and outside the state. The term "days spent in ports" does not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or because of seasonal reduction of service. Days in port are computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to, and inside the state and compensation of employees so engaged are apportioned to the state in the ratio which the number of days during which the services are rendered inside the state bears to the total number of days during which the services are rendered inside and outside the state.

§ 43.20.071 (1977)

(a) All business income of water transportation carriers shall be apportioned to this state by a fraction the numerator of which is the property factor plus the payroll plus the sales factor and the denominator of which is the number three.

(b) The property factor for fixed property such as buildings and land used in the business and local equipment and personal property shall be determined according to Art. IV of the Multistate Tax Compact (AS 43.19.010), and as provided in § 71 of this chapter for water transportation carriers. The property factor of water transportation property shall be determined on a days-spent-in-ports basis as provided in (e) of this section.

(c) The payroll factor for the wages and salaries of employees assigned to fixed locations shall be determined according to Art. IV of the Multistate Tax Compact (AS 43.19.010), and as provided in § 71 of this chapter for water transportation carriers. The payroll factor for water transportation carriers and other equipment used in water

transportation shall be determined on a days-spent-in-ports basis as provided in (e) of this section.

(d) The sales factor shall be determined on a days-spent-in-ports basis as provided in (e) of this section.

(e) The property, payroll and sales factor shall be determined by a ratio which the number of days spent in ports inside the state bears to the total number of days spent in ports inside and outside the state. The term "days spent in ports" does not include periods when ships are tied up because of strikes or withheld from Alaska service for repairs, or because of seasonal reduction of service. Days in port are computed by dividing the total number of hours in all ports by 24.

(f) Repealed by § 10 ch 1 SSSLA 1980 and § 9 ch 2 SSSLA 1980. (§ 1 ch 70 SLA 1975; am § 2 ch 110 SLA 1978; am §§ 8 – 11 ch 113 SLA 1980; am § 10 ch 1 SSLA 1980; am § 9 ch 2 SSSLA 1980)

§ 43.20.071 (Cum. Supp. 1980)

(a) All business income of water transportation carriers shall be apportioned to this state in accordance with the Multistate Tax Compact (AS 43.19) as modified by the following:

(1) the numerator of the property factor is the sum of the value for property in a fixed location, including buildings and land used in the business, and intrastate equipment and personal property determined according to the Multistate Tax Compact (AS 43.19), and the value of interstate mobile property determined on a days-spent-in-ports basis as provided in (4) of this subsection; the denominator of the property factor is determined according to the Multistate Tax Compact (AS 43.19);

(2) the numerator of the payroll factor is the sum of the wages and salaries of employees assigned to fixed locations determined according to the Multistate Tax Compact (AS 43.19) and the wages and salaries of employees assigned

to interstate mobile property determined on a days-spent-in-ports basis as provided in (4) of this subsection; the denominator of the payroll factor is determined in accordance with the Multistate Tax Compact (AS 43.19);

(3) the numerator of the sales factor is the sum of all revenues from intrastate activities and revenues from interstate activities determined on a days-spent-in-ports basis as provided in (4) of this subsection; the denominator is determined in accordance with the Multistate Tax Compact (AS 43.19);

(4) the portions of the numerator of the property, payroll, and sales factors which are directly related to interstate mobile property operations are determined by a ratio which the number of days spent in ports inside the state bears to the total number of days spent in ports inside and outside the state; the term "days spent in ports" does not include periods when ships are tied up because of strikes or withheld from Alaska service for repairs, or because of seasonal reduction of service; days in port are computed by dividing the total number of hours in all ports by 24.

(b) The department shall, by regulation, adopt formulas to ensure that the total income subject to apportionment under this chapter has been apportioned only to those states having jurisdiction to tax the income. Transportation carriers other than water carriers shall apportion their income to the state by means of the formulas adopted by the department.

Appendix I

Alaska scores in tax battle

Our Juneau Bureau

JUNEAU — The state has received a major boost in its multi-billion dollar tax fight with North Slope oil producers, top state legal and revenue officials said here Monday.

An Alaska Supreme Court decision Friday — which on the surface simply upheld the state's right to tax a Washington state fisherman — actually is "extraordinarily important" to the state's legal defense of its special income tax on oil and gas, Attorney General Wilson Condon said.

Out of various state court cases, the Friday decision "is the one major case" on which state attorneys will rely in the ongoing oil tax lawsuit, Condon said.

Three major oil producers have sued the state in protest of the 1978 oil and gas income tax, which could bring in $44 billion in state revenues over the life of the Prudhoe Bay field alone. But the state, Gov. Jay S. Hammond warns, could have to repay the industry as much as $7 billion by 1985 if it loses the court fight.

Friday's opinion by the Alaska Supreme Court probably won't be the final legal word in the oil tax battle, which may go as far as the U.S. Supreme Court.

But the ruling was a major boost for the state's case because it upheld some of the state's basic, but important principles for taxing interstate firms — including principles

See Back Page, STATE

State wins a big boost in tax battle with oil companies

Continued from Page A-1

involved in the court fight with the interstate oil producers, according to Condon and Joseph Donohue, deputy commissioner of taxation of the Alaska Department of Revenue.

Condon said the high court reaffirmed that the state has "enormous latitude" in imposing apportionment formulas, which are used to calculate an interstate firm's income — and therefore its income tax payments — in a particular state.

"The degree of flexibility the state has (with similar taxing methods) is a central issue" in the oil and gas income tax case, he added.

The oil and gas income tax case currently is before the state Superior Court. But unless it is settled outside of the courtroom, the lawsuit probably will advance to the Alaska Supreme Court and then eventually to the U.S. Supreme Court, a process that would take years.

Donohue said Friday's ruling will help the state argue its billion-dollar oil tax case at least as far as the Alaska Supreme Court. But he cautioned that the U.S. Supreme Court, while it could consider the Alaska justices' ruling, would not be bound by the opinion.

The 33-page decision upheld the state's right to tax the net income of crab fisherman John K. Sjong, who fished in international waters off Alaska's coast and sold his catch to Alaska processors.

Sjong sued the Alaska Department of Revenue after it notified him in 1974 that he owed $32,481 in unpaid taxes.

Officials cited the justices' statement in the Sjong case that, "A heavy burden is placed on a taxpayer challenging a state's allocation of his income to prove by 'clear and cogent evidence' that the income attributed to the state is 'out of all appropriate proportion to the business transacted ... in that State,' or has 'led to a grossly distorted result.'"

APPENDIX J
SUMMARY OF CONTACTS FOR APPORTIONMENT

OUTSIDE ALASKA	WITHIN ALASKA
1. Vessel constructed in Washington.	
2. Vessel moored in Washington for lay up and improvements	
3. Vessel repaired and maintained in Washington.	
4. Vessel documented in Washington	
5. Business managed in Washington:	
a. Location of owner's home and office;	
b. Financing;	
c. Legal;	
d. Accounting;	
e. Insurance;	
f. Contacts for sale of crab negotiated and entered;	
g. Payment made for crab caught and delivered.	
6. Crew hired in Seattle.	
7. Food taken on in Seattle.	
8. Fuel taken on in Seattle.	
9. Crew prepares vessel for season.	
10. Fishing operation entirely on high seas 5-150 miles offshore:	
a. Vessel navigated by crew from Washington to high seas grounds for fishing;	
b. Vessel fishes on grounds for periods of 5-15 days then radios to shore to confirm anticipated delivery;	b. Vessel in port one day to unload during which bait is purchased and occasionally extra water or fuel taken on. On occasion there has been i. Emergency repair to electronics performed by Seattle based firm and paid for in Seattle; ii. Emergency crew replacement.
c. Vessel navigated back to Seattle.	
11. Vessel laid up by crew in Washington off season.	

ALLOCATION BY DEPARTMENT OF REVENUE

OUTSIDE ALASKA		WITHIN ALASKA	
1970	15.1%	1970	84.9%
1971	14.8%	1971	85.2%
1972	8.0%	1972	92.0%

Motion to Dismiss or Affirm

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CLERK

No. 81-504

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

JOHN K. SJONG,

Appellant,

v.

STATE OF ALASKA,

Appellee.

On Appeal from the Supreme Court of the State of Alaska

MOTION OF STATE OF ALASKA TO DISMISS OR AFFIRM

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-504

JOHN K. SJONG,

Appellant,

v.

STATE OF ALASKA,

Appellee.

On Appeal from the Supreme Court of the State of Alaska

MOTION OF STATE OF ALASKA TO DISMISS OR AFFIRM

I. INTRODUCTION AND STATEMENT OF THE CASE

This appeal arises from a decision of the Alaska Supreme Court upholding the constitutionality of its state personal income tax as applied to an off-shore crab fisherman. Appellant's statement of the case omits significant facts that bear on this Court's decision whether the appeal raises any substantial federal questions. In particular, appellant fails to allude to the factual findings of the Department of Revenue, the Superior Court and the Supreme Court detailing the substantial contacts that the taxpayer's business has with Alaska. Those facts demonstrate that the tax is plainly constitutional under

the Due Process and Commerce Clauses of the United States Constitution.

Appellant is a commercial king crab fisherman who fishes in the international waters surrounding Alaska and who sells his catch exclusively in Alaska to Alaskan processors. Appellant maintains his vessel off season in the State of Washington, where it is outfitted, and negotiates a price for his catch in Seattle with representatives of Alaskan processing companies. Appendix to Jurisdictional Statement at F-2. Once the fishing season begins, however, appellant's only contacts are with Alaska. Appellant makes approximately 20-30 trips into an Alaskan port each season (once every five to fifteen days) to sell the crab and to obtain supplies, including bait purchased from local canneries and processors. *Id.* at F-2, F-3. The actual sale of the crab occurs only when appellant comes into the Alaskan port and transfers his catch to the processors. *Id.* at E-6, E-7. Appellant also enters Alaskan ports to obtain emergency medical treatment for his crew members and to have emergency repairs performed on his equipment. *Id.* at F-3.

This case addresses the issue of the constitutionality of the personal income tax imposed on appellant for tax years 1970, 1971 and 1972. That personal income tax was repealed in 1980, chs. 1 & 2, SSSLA 1980, and thus appellant is no longer subject to the tax.[1]

II. SUMMARY OF THE ARGUMENT

The Due Process and Commerce Clause limitations on state taxation of the income of multistate businesses have been considered by this Court on numerous occasions. *See, e.g., Exxon Corp. v. Department of Revenue*, 447

[1] The Department of Revenue agreed to withhold enforcement procedures against eleven other fishermen until this case was finally resolved. Their taxes may thus be affected for years up until the repeal. A fisherman doing business in the corporate form would be subject to the corporate net income tax which uses the formula at issue here.

U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978). In these cases and in the many state taxation cases decided during the last sixty years, this Court has established clear principles regarding the limits of state income taxation. The Alaska Supreme Court's decision is plainly consistent with these principles.

The Court has granted expansive power to the states to tax the income of a multistate business as long as there is a minimal connection between the taxpayer's interstate activities and the taxing state and a rational relationship between the income attributed to the state and the value of the enterprise in the taxing state. *Mobil Oil Corp v. Commissioner of Taxes, supra; Moorman Manufacturing Co. v. Bair, supra.* Alaska provides substantial services and benefits to appellant which enable him to continue his business and which make it a profitable business. Because appellant's sales are all in Alaska and substantially all his profits are from these sales, the Alaska Supreme Court applied this Court's precedents properly in finding that appellant's connections with the State justified imposition of the state income tax on his earnings from the sale of crab.

This Court should not consider appellant's discrimination claim because it was not raised in the court below. In any event, the formula does not discriminate against out-of-state fishermen since in-state fishermen are taxed on their total income and not just on an apportioned share. Appellant's claim of unconstitutionality based on the risk of multiple taxation, moreover, is frivolous since no other state—including Washington—taxes any of appellant's income; the speculative risk of multiple taxation has never been deemed sufficient by this Court to invalidate a state income tax. *See, e.g., Exxon Corp. v. Department of Revenue, supra; Moorman Manufacturing Co. v. Bair, supra.*

Finally, the court below was applying settled principles when it determined that the formula used by the State to attribute appellant's income complied with the Constitution. This Court has repeatedly refused to invalidate state taxes unless they were "inherently arbitrary or a mere effort to reach profits earned elsewhere. . . ." *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271, 283 (1924). The Alaska Supreme Court appropriately refused to find that the Department of Revenue's three-factor formula which attributed to Alaska between 85% and 92% of appellant's income was "inherently arbitrary." The record shows that 100% of appellant's sales were in Alaska, and therefore his bare assertion, unsupported in the record, that 95% of his activity was conducted outside Alaska should be ignored by this Court. Since a sales-only formula, such as that approved in *Moorman Manufacturing Co. v. Bair, supra*, would have attributed 100% of appellant's income to Alaska, the Alaska Supreme Court did not err in upholding the formula used here.

III. ARGUMENT

A. The Alaska Supreme Court Correctly Applied Settled Principles Established By This Court In Holding That Appellant's Contacts With This State Provide A Sufficient Nexus Under The Due Process Clause To Uphold Alaska's Application Of Its Net Income Tax

This Court has broadly sustained the power of states to tax the income of nonresidents in the face of challenges under the Due Process Clause. State taxation of income generated in interstate business satisfies the requirements of due process if there is a minimal connection between the interstate activities and the taxing state and a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 435-37 (1980); *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272-73 (1978). As this Court has held, the required

nexus is established if the taxpayer "avails itself of the 'substantial privilege of carrying on business' within the State . . . ." *Mobil Oil Corp. v. Commissioner of Taxes, supra,* 445 U.S. at 437, *quoting Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 444-45 (1940). All that is required is that the taxpayer must be "sufficiently involved in local events to forge 'some definite link, some minimum connection'. . . ." *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 465 (1959), *quoting Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-45 (1954). *See also Exxon Corp. v. Department of Revenue,* 447 U.S. 207, 220 (1980); *Standard Pressed Steel Co. v. Washington Department of Revenue,* 419 U.S. 560, 561-62 (1975).

The issue then is "whether the state has given anything for which it can ask return." *Wisconsin v. J.C. Penney Co., supra,* 311 U.S. at 444. The answer is clear here because appellant takes advantage of many benefits made available in Alaska to commercial fishermen such as bait, food, water, fuel, gear and parts. The State makes other benefits available to the appellant including "ports to unload and transfer the catch, labor markets, emergency repair services, safe harbors in stormy weather and a market in which the catch may be sold." Decision of the Department of Revenue, Appendix to Jurisdictional Statement at F-8. Most important, the taxpayer's income is derived from the market which is provided by the Alaskan processors. "Indeed, his crab fishing might be rendered totally uneconomic if he were foreclosed from selling to Alaskan processors and had to return to Seattle to sell his catch." *Sjong v. Department of Revenue,* 622 P.2d 967, 971 (Alaska 1981), Appendix to Jurisdictional Statement at D-7.

These services and benefits the State provides to appellant are directly related to his business and to the income he derives therefrom. Coupled with the fact that all appellant's sales are made in Alaska to Alaskan

processors, these benefits provide more than the minimal connection required by the Due Process Clause. Indeed, when appellant's contacts and connections with Alaska are compared with the connections deemed sufficient in other cases, the insubstantiality of appellant's due process claim becomes evident.

For example, in *Northwestern States Portland Cement Co. v. Minnesota*, *supra*, the taxpayer's only contact with the state was an office where orders were solicited, but all of the orders had to be accepted and filled from another state with deliveries made directly from out of state; application of the state corporate income tax to the taxpayer was easily upheld against a Due Process attack. 358 U.S. at 464-66. Similarly, in *Standard Pressed Steel Co. v. Washington Department of Revenue*, *supra*, this Court held that the Due Process Clause was not offended by an unapportioned gross receipts tax based on sales of fasteners to a Washington company where the only Washington activity of the taxpayer was one employee operating out of his home. That employee consulted with the Washington buyer regarding its anticipated needs for fasteners and followed up on any difficulties in the use of the products after delivery. All orders to the Washington company were filled, accepted and shipped from out of state and all payments were made out of state, but the tax was assessed on all the sales to that company. *Standard Pressed Steel Co. v. Washington Department of Revenue*, *supra*, 419 U.S. at 561. This Court upheld the gross receipts tax on all those sales, stating that the due process "question in the context of the present case verges on the frivolous." *Id.* at 562.

Appellant relies heavily on *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954), asserting that it prevents the State from relying on the delivery of the crab in Alaska to establish the requisite nexus under the Due Process Clause. That reliance is misplaced because *Miller Brothers* is plainly distinguishable from this case and because the limited nature of its holding has been reaffirmed recently by this Court in *National Geographic*

Society v. California Board of Equalization, 430 U.S. 551 (1977).

In *Miller Brothers*, the Court struck down the Maryland use tax (a tax only for use in Maryland of products which were bought outside Maryland) assessed against a Delaware store which occasionally delivered goods in Maryland and which sold goods at its Delaware store to Maryland residents. Thus, the sales to which Maryland unsuccessfully tried to apply its use tax were primarily sales made in Delaware to the Maryland residents at the Delaware store. In *National Geographic Society v. California Board of Equalization*, the Court in discussing and explaining *Miller Brothers* relied heavily on the fact that the finding of inadequate nexus was made because only occasional deliveries were made directly in Maryland, and there was a "lack of certainty that the merchandise sold over the counter to Maryland customers in Delaware was transported to Maryland prior to its use. . . ." 430 U.S. at 561-62.

By contrast, in *National Geographic Society*, the Court held that the Society's two offices for soliciting advertising within California were a sufficient nexus to justify the state's use tax upon the Society for its unrelated mail order sales to the state. *Id.* The Court found sufficient nexus despite the fact that the two offices had no connection to the mail order sales which were solicited from out-of-state offices and which were carried on solely by means of common carrier or mail. The Court highlighted that the nexus sufficient for due process purposes was established because the out-of-state taxpayer enjoyed services of the taxing states. *Id.* at 561.

Given the appellant's extensive and continuous contacts with the State of Alaska and his almost complete dependence on access to Alaska markets for the success of his operations, the argument that appellant's activities do not suffice to meet the minimum connection required

by the Due Process Clause is as frivolous as this Court held the taxpayer's argument was in *Standard Pressed Steel Co.* There, as here, the in-state activities of the taxpayer "made possible the realization and continuance of valuable contractual relations between [the seller and its customers]." *Standard Pressed Steel Co. v. Washington Department of Revenue, supra,* 419 U.S. at 562. This Court's precedents clearly support the Alaska Supreme Court's rejection of appellant's due process claim because the taxpayer has for ten years been selling exclusively to Alaskan processors and his "principal source of income is the money which he receives in payment for crab delivered to those processors." *Sjong v. Department of Revenue, supra,* 622 P.2d at 972, Appendix to Jurisdictional Statement at D-9.

B. The Alaska Supreme Court Correctly Applied This Court's Commerce Clause Precedents In Upholding The Apportionment Formula Utilized In This Case

Appellant raises three challenges to the apportionment formula used by the State in attributing his income. First, he claims that the apportionment formula is tailored to subject out-of-state fishermen to greater taxation thereby discriminating against them. Second, he insists that the risk of multiple taxation, despite the absence of actual multiple taxation, is sufficient to invalidate the tax. Finally, he claims that the apportionment formula produces a distorted result thereby attributing income to Alaska out of all proportion to that which is earned in the State. None of these claims raises a substantial issue for this Court.

Appellant raises specifically for the first time in this Court the question of discrimination in the promulgation of the formula at issue here. Appellant asserts that the formula discriminates against nonresident fishermen because Alaska resident fishermen not doing business in other states pay no taxes outside of Alaska whereas

nonresident fishermen would pay taxes in more than one jurisdiction. Because this issue was never considered by the Alaska courts, it cannot be raised now to this Court. The Alaska Supreme Court specifically stated that the point would not be considered because it had not been briefed by either party. *Sjong v. Department of Revenue*, *supra*, 622 P.2d at 973, Appendix to Jurisdictional Statement at D-12. This Court has repeatedly refused to consider issues not raised or decided by the highest court of the state in cases where the constitutionality of a state statute has been upheld. *See, e.g., Wilson v. Cook*, 327 U.S. 474, 483-84, (1946); *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 317 (1937). There is no reason to depart from that rule here.[2]

Appellant's multiple taxation claim is equally without merit. Washington imposes no income tax and therefore the only income tax to which appellant is subject is the Alaska tax at issue here. He claims, however, that the mere fact that Washington could assess an income tax based on his income earned from fishing activities creates

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[2] Moreover, even if the Alaska Supreme Court had considered the issue, there is no viable discrimination claim here. Although appellant complains that the tax is based improperly on 90% of his income, were he a resident of Alaska that tax would be on 100% of his income. This is not a case like *Maryland v. Louisiana*, 101 S. Ct. 2114 (1981) where this Court found a discrimination against interstate commerce. Louisiana assessed a use tax against gas produced from the Outer Continental Shelf but gave credits and exemptions for those producers that paid Louisiana severance taxes with the purpose and effect of having only that gas moving out of Louisiana subject to the tax. "[T]he Louisiana First-Use Tax unquestionably discriminates against interstate commerce in favor of local interests as the necessary result of various tax credits and exclusions." *Id.* at 2134. By contrast, in Alaska all fishermen, whether resident or nonresident, are assessed an income tax at the same rate and the tax for Alaska residents doing business only in Alaska is assessed on the basis of their total income and not, like appellant, on only an apportioned share.

a risk of multiple taxation justifying invalidation of Alaska's apportionment formula.

This Court has consistently rejected claims raising only the risk of multiple taxation where no actual multiple taxation has been shown. For example, in both *Mobil Oil Corp. v. Commissioner of Taxes*, *supra*, and *Exxon Corp. v. Department of Revenue*, *supra*, the taxpayer claimed that the state's apportionment formula subjected it to the risk of multiple taxation. Although noting in each case that the constitutionality of a state's tax does not depend upon "the vagaries" of another state's law, this Court stated that "nonetheless 'the absence of any existing duplicative tax does alter the nature of appellant's claim.' " *Exxon Corp. v. Department of Revenue*, *supra*, 447 U.S. at 229, *quoting Mobil Oil Corp. v. Commissioner of Taxes*, *supra*, 445 U.S. at 444. And as this Court said in *Moorman Manufacturing Co. v. Bair*, *supra*, 437 U.S. at 280, "it would be an exercise in formalism to declare appellant's income tax assessment unconstitutional based on speculative concerns with multiple taxation." Since no other state imposes an income tax on appellant's income, this Court's Commerce Clause cases render appellant's multiple taxation claim frivolous.[3]

Appellant's remaining attack on the apportionment formula is that it results in an unfair allocation of his income to the State. In assessing the constitutionality of various states' apportionments of the income of multistate businesses, this Court has repeatedly emphasized the broad latitude provided to each state. A valid state tax

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[3] Certainly, *Exxon Corp. v. Dep't of Revenue*, 447 U.S. 207, 228-29 n.12, lays to rest any claim appellant may have concerning multiple taxation based on income taxes in Alaska and property or other taxes in Washington. This Court applauded the Wisconsin Supreme Court's conclusion that the imposition of " 'severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income.' "

has been held to be one which "reached, and was meant to reach, only the profits earned within the state." *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920). This Court has required only that a state income tax not be "inherently arbitrary or a mere effort to reach profits earned elsewhere. . . ." *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271, 283 (1924). A reasonable approximation of profits attributable to activities in the state is sufficient and will be sustained unless the tax is levied upon an amount "out of all appropriate proportion to the business transacted [within] that state." *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135-36 (1931).

Turning to the formula applied in this case, the Department of Revenue originally had decided that appellant's income should not be apportioned but should be allocated entirely to the State of Alaska. Upon appellant's initial protest, the Department held hearings and concluded that appellant's contacts with Washington were sufficient to authorize Washington to impose an income tax even though Washington did not do so. Therefore, the Department of Revenue determined that all of appellant's income should not be attributed to Alaska and an apportionment formula should be applied. The formula resulted in apportionment of between 85% and 92% of appellant's income to Alaska for 1970, 1971 and 1972.

The apportionment formula attributed income to the State based on a ratio of the taxpayer's property, sales and payroll in the State to property, sales and payroll outside the State. First, all sales were attributed to Alaska where the property was sold and delivered. This attribution in the formula of all sales to the destination state is a common feature of apportionment formulas nationwide, is part of the Multistate Tax Compact Regulations, and was used by Iowa in the sales-factor formula

approved by this Court in *Moorman Manufacturing Co. v. Bair, supra*, 437 U.S. at 278 n.13. Next, the property factor was determined on a days-in-port basis as provided in the statute then applicable, Alaska Stat. 43.20.130(g) (repealed ch. 70, § 13, SLA 1975). The number of days the taxpayer's vessel was in Alaskan ports was compared to the number of days spent in ports outside the State. Finally, the payroll factor was determined based on sales in the State because the Department found that wages of the employees were based on the sales of the crab caught and not on their operation of the vessel. The Department exercised its authority under Alaska Stat. 43.20.140 to determine the payroll factor in this manner rather than using the days-in-port basis specified in Alaska Stat. 43.20.130(g) because the days-in-port method was found not to adequately reflect the actual wages for business generated in Alaska.

Appellant insists that the State should have used a formula which ignored sales entirely and calculated the property and payroll factors based on the annual days in service in Alaska compared to annual days in service nationwide. But the Commerce and Due Process Clauses do not require a state to allow a taxpayer to choose a formula that allocates its income in a manner to minimize its taxes. The Constitution gives the states substantial leeway in developing apportionment formulas. "Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments." *International Harvester Co. v. Evatt*, 329 U.S. 416, 422-23 (1947).

Indeed, the Court has upheld many different state formulas besides a property, payroll and sales formula against attacks similar to appellant's: one-factor sales formulas in *Moorman Manufacturing Co. v. Bair, supra*,

and *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939); one-factor property formulas in *Underwood Typewriter Co. v. Chamberlain*, *supra*; one-factor mileage formulas in *Norfolk and Western Railway v. North Carolina ex rel. Maxwell*, 297 U.S. 682 (1936); and two-factor property and sales formulas in *United States Glue Co. v. Town of Oak Creek*, 247 U.S. 321 (1918).

The taxpayer's dissatisfaction with the formula used is only of constitutional significance if he can show that the apportionment was "inherently arbitrary" or "produced an unreasonable result." *Underwood Typewriter Co. v. Chamberlain*, *supra*, 254 U.S. at 121. He must prove by "'clear and cogent evidence' that the income attributed is in fact 'out of all appropriate proportion to the business transacted . . . in that State,' . . . or has 'led to a grossly distorted result.'" *Moorman Manufacturing Co. v. Bair*, *supra*, 437 U.S. at 274, *quoting Hans Rees' Sons v. North Carolina ex rel. Maxwell*, *supra*, 283 U.S. at 135 and *Norfolk and Western Railway v. Missouri State Tax Commission*, 390 U.S. 317, 326 (1968).

Appellant contends that 95% of his business activity is conducted outside the State and therefore an apportionment of between 85% and 92% of his income to Alaska is "grossly excessive." Nowhere in the record is there any support for appellant's 95% figure; what factors appellant includes in that calculus remain a mystery and the number is nothing more than appellant's bald assertion. Indeed, the record demonstrates to the contrary that all of appellant's sales are made in Alaska, and his income is virtually all from those sales. That not all the activity that goes into producing the income occurs in Alaska does not prohibit Alaska from taxing that income. "The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state

for which the tax is an exaction." *Wisconsin v. J.C. Penney, supra*, 311 U.S. at 445.

This Court has upheld against constitutional attack many formulas that were alleged to over-attribute income to the taxing state. For example, in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, supra*, this Court sustained New York's one-factor property formula despite the objections of the taxpayer that its New York operations produced no net income. 266 U.S. at 282. *Similarly*, in *Underwood Typewriter Co. v. Chamberlain, supra*, the Court upheld California's use of a one-factor property formula to apportion the net income of a company which had its manufacturing concerns all within that state but sold its products entirely outside of the state. Connecticut's single-factor property formula which resulted in taxation of 47% of the company's net income was approved despite the taxpayer's claim that 97% of its profits were generated by transactions in tangible personal property outside the state. 254 U.S. at 120. Finally, in *Moorman Manufacturing Co. v. Bair, supra*, despite the taxpayer's showing that his tax was 50% higher as calculated by a sales-only factor rather than a three-factor formula, 437 U.S. at 271 nn.4 & 5, this Court refused to find that the single-factor sales formula produced "an arbitrary result," *id.* at 275.

The Alaska Supreme Court's decision that the application of Alaska's apportionment formula to appellant did not produce a "grossly distorted result," *Sjong v. Department of Revenue, supra*, 622 P.2d at 978, Appendix to Jurisdictional Statement at D-21, is entirely consistent with these and other prior decisions of this Court. Indeed, had Alaska used the Iowa sales-factor formula upheld by this Court in *Moorman Manufacturing Co. v. Bair, supra*, appellant would have been taxed on 100% of his income in this case.

IV. CONCLUSION

Because the Alaska Supreme Court has correctly applied the Due Process and Commerce Clause doctrines as consistently enunciated by this Court, the State of Alaska respectfully requests this Court to dismiss this appeal for want of a substantial federal question or alternatively to affirm the judgment of the Alaska Supreme Court.

Respectfully submitted,

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Appellant's Reply Brief

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IN THE

Supreme Court of the United States

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Appellee.

ON APPEAL FROM THE
SUPREME COURT OF THE STATE OF ALASKA

APPELLANT'S BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM

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ARGUMENT

I. THE SOLE CONTACT BETWEEN SJONG AND ALASKA IS DELIVERY OF HIS CATCH. SUCH LIMITED CONTACT IS INSUFFICIENT TO ESTABLISH JURISDICTION TO LEVY ANY INCOME TAX.

Sjong's contacts with Alaska are extremely limited. His fishing business is conducted entirely outside Alaska except for stops of usually one day during the season to deliver his catch pursuant to contracts negotiated in Washington.

All the cases where this Court has upheld jurisdiction involve some showings of *permanent presence* in the taxing state — either a local office or a resident representative. Sjong has no permanent presence; indeed, his activities within Alaska are transient. His permanent presence is solely in the State of Washington.

II. THE ALASKA SUPREME COURT HELD THAT ALASKA COULD APPORTION 90% OF SJONG'S INCOME TO ITSELF EVEN THOUGH 95% OF HIS BUSINESS ACTIVITY IS OUTSIDE ALASKA. SUCH A DISTORTED RESULT CANNOT BE SUSTAINED.

The Alaska Supreme Court based its decision on the assumption that 95% of Sjong's business activity is conducted outside Alaska. 622 P.2d at 977 and 978; Jurisdictional Statement D-19 and D-20. It nevertheless upheld the apportionment of 85% to 92% of Sjong's income to Alaska. Such a result is "out of all appropriate proportion to the business transacted by the appellant in that State,"[1] produces a "grossly distorted result,"[2] and cannot be sustained.

In response to Sjong's suggestion below that a service days method be applied, Alaska counters that

[1] *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

[2] *Norfolk & Western R. Co. v. Missouri Tax Comm'n*, 390 U.S. 317, 326 (1968).

the commerce and due process clauses do not require a state to allow a taxpayer to choose a formula.[3] That argument misses the point. Many different methods might be employed to apportion income. Several measures that have been considered in this case are set forth in the Jurisdictional Statement, p. 16, n. 16.[4] Additional measures might be considered as well.[5] But no method reasonably intended to measure the portion of Sjong's business conducted in Alaska will justify the tax imposed by Alaska in this case.

[3]Motion to Dismiss p. 12. Alaska incorrectly says that Sjong "insists" on use of a service days formula. Sjong did suggest such a method below as a fair way of apportioning income from a fishing enterprise. But he has insisted only that the state's proposed methods of taxation constitute a gross distortion and cannot be upheld. This was true of Alaska's original effort to tax 100% of his income without apportionment (see Motion to Dismiss p. 11), and remains true when considering the nominal reduction to 90% made by the audit division of the Alaska Department of Revenue.

[4]It is important to note that the audit division, without further hearing, rejected even the method preferred by the hearing examiner. He would have employed by analogy a statute applicable to freight and passenger carriers, which as originally adopted would have applied the port days method to both the payroll and property factors. AS 43.20.130. Jurisdictional Statement p. 12, n. 13. The audit division rejected this approach and applied a 100% sales factor for both sales and payroll, using the port days method only for property. The statute actually in effect at the time of the decision for passenger or freight water transportation carriers (AS 43.20.071) would have applied the port days method to all three factors – sales, property and payroll. The hearing examiner's method would have reduced the percentage attributable to Alaska to as low as 68%. The method in AS 43.20.071 would have attributed as little as 58% of Sjong's income to Alaska. Sjong has always argued that a port days approach does not fairly attribute income from a fishing venture, particularly when it excludes virtually all time in the home port where essential business is conducted. But even if that method is used, the port days computation contemplated by Alaska's statutes would attribute significantly less than 90% of Sjong's income to Alaska.

[5]Use of the ordinary three factor formula as adopted in Alaska would have attributed payroll entirely to Washington where the crew was based, hired, paid and resided, making that thrid of the formula for Alaska zero percent. AS 43.19.010, Art. IV, paragraph 14 and AS 43.20.130(c) both provided for such an allocation.

The record establishes that Sjong fishes in waters outside Alaska's jurisdiction for about ten days for every one he spends in Alaska delivering his catch. He is in his home port of Seattle for over a third of the year conducting business essential to his fishing venture. See, *e.g.*, Jurisdiction Statement Appendix J. In order to maximize fishing time, his stops in Alaska are as brief as possible and his activities there are minimal.[6]

While Alaska contends that Sjong has not provided an accounting of activities to show the exactitude of the 95% of business activities, the Alaska Supreme Court assumed that the extent of Sjong's activities outside Alaska territory might well approach that estimate. A table comparing activities inside and outside Alaska territory appears at Appendix J of the Jurisdictional Statement.

Alaska further misstates the record. It is not to an Alaskan processor that Sjong delivers (Motion to Dismiss, page 2), but rather to the Alaska plant of a Seattle-based and domiciled company. (Jurisdictional Statement, Appendix E 3). The "emergency repair" sought in Alaska by Sjong is one occasion of electronic repair by a Seattle-based firm. No other repair facilities are utilized or even available. Though the hearing examiner found use of Alaska ports in storms, and that finding has been repeated in the courts below as well as Alaska's brief here, it likewise has no record support. The area fished is on the high seas beyond Alaska territory and outside Alaska's power to tax. *Alaska v. Arctic Maid*, 366 U.S. 199 (1961).

Alaska does not argue that the result produced by its apportionment method is fair. It does not dispute the statements of the Superior Court below that the State's

[6]Sjong ordinarily drops off his catch, takes on bait and water and returns immediately to sea. In an emergency he might take on other supplies or make repairs, but such instances have been rare.

apportionment formula does not fit the circumstances of this case and is unfair.[7] Rather, it defends its power to attribute such a disproportionate share of income to Alaska by relying on the absence of an income tax in Washington and what it perceives to be the effectively unlimited power of a state to apply any method of apportionment it chooses.

III. ALASKA DOES NOT DEFEND THE FAIRNESS OF ITS METHOD OF APPORTIONING THE INCOME OF WASHINGTON FISHERMEN.

A. The Fact That Washington Has No Income Tax Does Not Immunize Alaska's Apportionment of 90% of the Income of Washington Fishermen to Itself From Constitutional Review.

Whenever pressed on the fairness of its apportionment formula, Alaska has always fallen back on the fact that since Washington – where Sjong resides and bases his business – has no income tax, no multiple taxation of income can occur. From this it concludes that the apportionment of any percentage of Sjong's income to Alaska, even 100%, must be sustained.[8] Under Alaska's approach, the decisive factor is Washington's decision to raise its revenue by other taxes (taxes paid by Sjong) instead of an income tax. The fact that duplicative taxation of the same income is virtually

[7] Transcript of Argument on Appeal at 5-6, quoted in Jurisdictional Statement at 14-15.

[8] *See* Motion to Dismiss pp. 4,14.

certain if Washington adopts an income tax is, according to Alaska, altogether irrelevant. Such an argument ignores basic, controlling constitutional principles.[9] The fact of multiple taxation illustrates that income has been misapportioned, but it is not a prerequisite to finding that a state is taxing extraterritorial values.[10]

In order to be sustained under the commerce clause, the four-part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), must be met, including the requirements of fair apportionment. Due process requires not only minimal contacts to establish jurisdiction, but a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *E.g., Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 219-20 (1980). See Jurisdictional Statement pp. 20-21. Alaska's apportionment method must pass these tests independently of whether Washington imposes an income tax of its own, and it cannot do so.

B. Alaska Misreads *Moorman* As Permitting It To Apportion Even 100% of Washington Fishermen's Income to Itself.

The Department of Revenue originally sought to tax 100% of Sjong's income. Motion to Dismiss p. 11.

[9]As begrudgingly acknowledged by Alaska (Motion to Dismiss p. 10), this court has held that the constitutionality of one state's tax does not depend on the vagaries of another state's tax policy. *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 229 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980).

[10]This Court has prohibited extraterritorial taxation at least since its decision in *Louisville & Jefferson Ferry Co. v. Kentucky*, 188 U.S. 385 (1903). Even where there is jurisdiction to tax, due process requires that the measure of the tax fairly reflect the taxpayer's activities in the state. *See, e.g., Union Tank Line Co. v. Wright*, 249 U.S. 275 (1919).

When the hearing examiner determined that apportionment was required because of the taxpayer's significant business activity in Washington, the audit division came back with an application of the apportionment formula that still attributed 90% of Sjong's income to Alaska. Alaska justifies this extremely large percentage by claiming that it could have used a sales-only formula approved in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), to tax 100% of Sjong's income. Motion to Dismiss pp. 4, 14. Thus, Alaska implies, a 90% attribution of income cannot be questioned.

Alaska's argument of *Moorman* (which was decided while this appeal was under advisement before the Superior Court) persuaded the Superior Court judge below that despite his belief Sjong's income was not fairly apportioned, he must uphold a formula based almost entirely on sales. As pointed out in the Jurisdictional Statement pp. 14-19, such reasoning misreads *Moorman*. The formula applied in this case is not a longstanding formula uniformly applied, one that lets the chips fall where they may with regard to any particular taxpayer. This formula was especially tailored for Sjong and similarly situated Washington fishermen, based on their particular factual situation, to maximize the income taxable by Alaska.

Further, the bare statement that delivery is equivalent to sale begs the question. The contract for delivery and payment both take place outside Alaska. As noted in the Jurisdictional Statement, page 8, delivery was insufficient nexus to impose a tax at all in *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954).

Alaska's willingness to defend a 90% attribution of income to itself by arguing that *Moorman* would permit it to tax 100% of Sjong's income demonstrates its total disregard for due process, equal protection and the commerce clause. It is not disputed that Sjong's business is based in Washington, that his vessel spends nearly

half the year there, and that most significant income generating activity is conducted outside Alaska. To state, as Alaska does at pages 4 and 14 of its Motion to Dismiss, that Alaska could look only to delivery in Alaska and tax 100% of Sjong's income is absurd. The implication that Alaska might attempt to tax 100% of such income is real, since in fact it attempted to do just that. But the suggestion that such an attempt would meet minimal constitutional standards (and thus that a 90% apportionment is necessarily protected) is without merit. In substance, Alaska urges that it is not required to apportion. That position has never had support in this court's decisions.

C. Alaska Relies On The False Assumption That Its Token Apportionment Is Sufficient For This Court To Overlook Its Fairness.

In the final analysis, Alaska does not justify its taxation of 90% of Sjong's income by a showing that such an apportionment is fair or reasonably related to Sjong's business activity in Alaska. Rather, it relies on the hope that this Court will defer to Alaska's action despite the misapportionment of Sjong's income.

This Court's willingness to defer to the states in doubtful cases does not extend to extreme situations such as this one, where one state attempts to exploit the absence of any income tax in another state when taxing the income of that sister state's citizens. Alaska's hope that this Court will defer to its actions no matter what it does is, appellant believes, misplaced.

CONCLUSION

This Court should summarily reverse or, in the alternative, accept briefs and arguments on the merits.

DATED this 16 day of December, 1981.

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